

A SOUTH AFRICAN PERSPECTIVE ON SOME CRITICAL ISSUES REGARDING THE OECD MODEL TAX CONVENTION ON INCOME AND ON CAPITAL, WITH SPECIAL EMPHASIS ON ITS APPLICATION TO TRUSTS

IZELLE DU PLESSIS



**Dissertation presented for the degree of
Doctor of Laws
in the
Faculty of Law
at
Stellenbosch University**

**SUPERVISOR: PROF MJ DE WAAL
EXTERNAL CO-SUPERVISOR: DR CP DU TOIT**

DECEMBER 2014

DECLARATION

By submitting this dissertation electronically, I declare that the entirety of the work contained therein is my own, original work, that I am the sole author thereof (save to the extent explicitly otherwise stated), that reproduction and publication thereof by Stellenbosch University will not infringe any third party rights and that I have not previously in its entirety or in part submitted it for obtaining any qualification.

Date: 27 August 2014

OPSOMMING

Trusts word vir 'n groot verskeidenheid doeleindes gebruik, nie net in Suid-Afrika nie, maar ook in die buiteland. Net soos baie ander entiteite funksioneer trusts baie keer nie net in een jurisdiksie nie. Trusts word dus ook blootgestel aan internasionale dubbelbelasting. Soos die meeste ander state, sluit Suid-Afrika dubbelbelastingooreenkomste om die effek van internasionale dubbelbelasting te beperk. Die meeste van hierdie ooreenkomste is gebaseer op die OECD Model Tax Convention on Income and on Capital (die OECD MTC).

Die Suid-Afrikaanse trust het 'n unieke aard. Dit is nie gebaseer op die konsep van verdeelde eiendomsreg waarop die meeste gemeenregtelike trusts gebaseer is nie, maar tog is dit ook nie 'n regspersoon nie. Die vraag wat hierdie navorsing probeer beantwoord is hoe Suid-Afrika sekere bepalinge van die OECD MTC sal interpreteer en toepas op trusts. Alhoewel die Suid-Afrikaanse posisie ondersoek word, word dit deurgaans vergelyk met die posisie in die Verenigde Koninkryk, Kanada en Nederland.

Die proefskrif begin met 'n analise van die trustreg in elk van die betrokke state en word gevolg deur 'n oorsig van die belastingstelsel wat trusts (en die partye daartoe) belas in elk van die state. Die status van dubbelbelastingooreenkomste en hul interpretasie word ondersoek voordat sekere kritiese bepalinge van die OECD MTC geanaliseer word om vas te stel hoe Suid-Afrika hierdie bepalinge sal toepas op trusts. Daar word dus ondersoek of 'n trust beskou sal word as 'n persoon, of dit 'n inwoner en 'n uiteindelik geregtigde kan wees vir doeleindes van die OECD MTC. Voorts word moontlike oplossings vir toerekeningskonflikte in die toepassing van dubbelbelastingooreenkomste op trusts, ondersoek.

Die proefskrif kom tot die gevolgtrekking dat in Suid-Afrika die trust beskou sal word as 'n persoon vir doeleindes van die OECD MTC. Verder sal sommige tipes trusts gesien word as inwoners en as uiteindelik geregtigdes vir doeleindes van die OECD MTC. Die oplossing voorgestel in die OECD se Verslag oor Vennootskappe behoort toegepas te word om toerekeningskonflikte op te los.

ABSTRACT

Trusts are used for a variety of purposes, both in South Africa and abroad. Like so many other entities, trusts often do not function only in one jurisdiction and may therefore be exposed to international double taxation. South Africa, like most other states, enters into bilateral double taxation treaties, to limit the effects of international double taxation. Most of these treaties are based on the OECD Model Tax Convention on Income and on Capital (the OECD MTC).

The South African trust is a unique creature. It is not based on the dual ownership concept on which most common law trusts are based, yet, it is not a juristic person either. The question that this research aims to address is how South Africa will interpret and apply certain provisions of the OECD MTC to trusts. Although the South African position is investigated, it is compared to the positions of the United Kingdom, Canada and the Netherlands.

The dissertation starts with an analysis of the trust law in each of the relevant states, followed by an overview of the taxation regime governing trusts (and the parties thereto) in each state. The status of double taxation treaties and their interpretation are examined before certain critical provisions of the OECD MTC are analysed to determine how South Africa will apply these provisions to trusts. Hence it is explored whether a trust will be regarded as a person, whether it may be a resident and a beneficial owner for purposes of the OECD MTC. Furthermore, possible solutions for conflicts of attribution in the application of double tax conventions to trusts are investigated.

The dissertation concludes that South Africa will regard a trust as a person for purposes of the OECD MTC. Moreover, some types of trusts may be viewed as residents and as beneficial owners for purposes of the OECD MTC. The solution proposed in the OECD's Partnership Report should be applied to resolve conflicts of attribution involving trusts.

ACKNOWLEDGEMENTS

I would like to express my sincere thanks and appreciation to the following persons:

My supervisor, Prof Marius de Waal, for his guidance, encouragement and support. He has spent an enormous amount of time and energy reading and discussing my dissertation and guiding me through this process. I am grateful for his patience, his meticulous notes, his sound advice and his wisdom. I could not have asked for a better supervisor!

My co-supervisor, Dr Charl du Toit, for his invaluable input in my dissertation. I have had the benefit of his expertise and skill, not only in international tax law, but also in the process of writing a dissertation. I am grateful that he agreed to be my supervisor.

Prof Lynette Olivier for her guidance on the initial chapters of this dissertation.

My colleagues at the Law Faculty of the University of Stellenbosch for their encouragement and support. Special mention must be made of my colleagues and friends Karin Calitz and Enelia Jansen van Rensburg. Karin's care, encouragement and prayers has played a huge part in my ability to write (and finish!) this dissertation. Enelia was always available to bounce ideas off, to argue a point with or to offer a kind word of support.

On a more personal note, I would like to thank the following people by dedicating this dissertation to them:

My husband, Petru du Plessis, who has been a pillar of strength for me throughout this process (and throughout our lives together). His love, encouragement, prayers and support and above all, his belief that I will succeed, has given me the strength to write this dissertation.

Our two precious daughters, Elsa and Christine. I hope that this dissertation will, in some way, inspire you, just as you have inspired me.

My mother Ethel Steyn (and late father, Pierre Steyn) for their unfailing love, support and encouragement. I hope I have made you proud. My mother is one of the kindest and most loving people I know and I could not have written this dissertation without her support.

Still on a personal note, I would also like to thank:

My brother, Willem Steyn and sister, Christelle Heyns and their families, as well as my parents-in-law, Boetie and Bettie du Plessis, for their support and encouragement.

Mrs Judy Paulse, not only for taking such good care of our two little girls while I was working on this dissertation, but also for loving them.

Above all, I would like to thank our Heavenly Father, for His grace and love and for granting me the ability and opportunity to write this dissertation.

TABLE OF CONTENTS

<i>Declaration</i>	<i>i</i>
<i>Opsomming</i>	<i>ii</i>
<i>Abstract</i>	<i>iii</i>
<i>Acknowledgements</i>	<i>iv</i>
<i>Table of Content</i>	<i>v</i>

CHAPTER 1: INTRODUCTION1

Chapter overview	1
1.1 Background	2
1.1.1 Trusts and their use	2
1.1.2 Double taxation and the OECD Model Tax Convention on Income and on Capital	2
1.2 The main research question	3
1.3 Examples	4
1.4 Methodology.....	4
1.5 Scope of the dissertation	6
1.6 Brief overview of the existing literature regarding the application of the OECD MTC to trusts	8
1.7 Overview of the content of the dissertation	9

CHAPTER 2: THE DEFINITION, NATURE AND KEY FEATURES OF A TRUST10

Chapter overview	10
2.1 Introduction	12
2.2 South Africa.....	12
2.2.1 A brief history.....	12
2.2.2 Legal basis for the reception of the trust.....	13
2.2.3 Definitions.....	14
2.2.4 Legal nature and key features	16
2.2.5 Requirements for the formation of a valid trust	21
2.2.6 Administration of a trust.....	23
2.3 United Kingdom	24

2.3.1	A brief history.....	24
2.3.1.1	General	24
2.3.1.2	England	24
2.3.1.3	Scotland	26
2.3.2	Definitions.....	27
2.3.2.1	England	27
2.3.2.2	Scotland	29
2.3.3	Legal nature and key features	29
2.3.3.1	England	29
2.3.3.2	Scotland	32
2.3.4	Requirements for the formation of a valid trust	35
2.3.4.1	England	35
2.3.4.2	Scotland	38
2.3.5	Administration of a trust.....	39
2.3.5.1	England	39
2.3.5.2	Scotland	40
2.4	Canada	41
2.4.1	Introduction	41
2.4.2	A brief history.....	42
2.4.2.1	The rest of Canada.....	42
2.4.2.2	Québec.....	42
2.4.3	Definitions.....	43
2.4.3.1	The rest of Canada.....	43
2.4.3.2	Québec.....	44
2.4.4	Legal nature and key features	45
2.4.4.1	The rest of Canada.....	45
2.4.4.2	Québec.....	47
2.4.5	Requirements for the formation of a valid trust	49
2.4.5.1	The rest of Canada.....	49
2.4.5.2	Québec.....	50
2.4.6	Administration of a trust.....	51
2.4.6.1	The rest of Canada.....	51
2.4.6.2	Québec.....	52
2.5	The Netherlands	52

2.5.1	Introduction	52
2.5.2	Accent to the Hague Convention on Trusts	54
2.6	OECD MTC.....	55
2.7	Conclusion.....	55
CHAPTER 3: THE TAXATION OF TRUSTS		60
Chapter overview		60
3.1	Introduction	62
3.2	South Africa.....	64
3.2.1	Introduction	64
3.2.2	The taxation of trusts and beneficiaries	65
3.2.3	Income retains its nature	68
3.2.4	Income deemed to be that of another	70
3.2.5	Conclusion.....	74
3.3	United Kingdom	74
3.3.1	Introduction	74
3.3.2	Discretionary trusts.....	74
3.3.2.1	Taxation of the trustee of a discretionary trust	75
3.3.2.1.1	Charge on the trustee on receipt of income	75
3.3.2.1.2	Charge on the trustee on making a discretionary payment of income.....	75
3.3.2.2	Taxation of the beneficiary.....	76
3.3.2.2.1	Charge on the beneficiary on receiving a discretionary payment of income	76
3.3.2.2.2	Discretionary trust treated as transparent	77
3.3.3	Fixed trust	78
3.3.3.1	Taxation of the trustee	78
3.3.3.2	Taxation of the beneficiary.....	78
3.3.4	Settlor-interested trusts.....	79
3.3.5	Payments to minor unmarried children of the settlor	80
3.3.6	Transfer of assets abroad.....	81
3.3.7	Conclusion.....	81
3.4	Canada	82
3.4.1	Introduction	82

3.4.2	The taxation of trusts	82
3.4.3	The taxation of beneficiaries	83
3.4.4	Flow-through character of income	84
3.4.5	Income taxed in the hands of the settlor	85
3.4.6	Non-resident trusts and non-resident beneficiaries	86
3.4.7	Conclusion	88
3.5	The Netherlands	88
3.5.1	Introduction	88
3.5.2	<i>Afgezonderd particulier vermogen</i>	89
3.5.3	The APV legislation is not applicable	90
3.5.4	Conclusion	92
3.6	Conclusion	92

CHAPTER 4: INTERPRETATION AND STATUS OF DOUBLE TAX TREATIES.....95

Chapter overview	95
4.1 Introduction	96
4.2 Background to the OECD MTC	96
4.3 Interpretation of the OECD MTC	98
4.3.1 General points regarding the interpretation of DTTs	98
4.3.2 South Africa	101
4.3.2.1 The Constitution	101
4.3.2.2 Case law	102
4.3.3 United Kingdom	109
4.3.4 Canada	110
4.3.5 The Netherlands	110
4.4. Status of tax treaties	111
4.4.1 South Africa	111
4.4.2 United Kingdom	120
4.4.3 Canada and the Netherlands	121
4.5 Conclusion	121

CHAPTER 5: IS THE TRUST A PERSON FOR PURPOSES OF THE OECD MTC? 124

Chapter overview 124

5.1	Introduction	125
5.2	Any other body of persons	128
5.2.1	Introduction	128
5.2.2	South Africa.....	129
5.2.3	United Kingdom	130
5.2.4	Canada.....	131
5.2.5	The Netherlands.....	131
5.2.6	Does the context require otherwise?	132
5.3	Entity that is treated as a body corporate for tax purposes	137
5.4	Ordinary meaning of the term person.....	139
5.5	Trust <i>versus</i> trustee	140
5.6	Characterisation.....	142
5.7	Conclusion.....	144

CHAPTER 6: THE RESIDENCE OF A TRUST UNDER THE OECD MTC..... 146

Chapter overview 146

6.1	Introduction	148
6.2	The requirements of article 4(1) of the OECD MTC.....	149
6.2.1	Introduction	149
6.2.2	Liability to tax and fiscal transparency	150
6.2.2.1	General comments	150
6.2.2.2	Trust <i>versus</i> trustee	152
6.2.2.3	Fiscal transparency	157
6.2.2.3.1	General	157
6.2.2.3.2	Degrees of transparency	157
6.2.2.3.3	Partially transparent entities.....	160
6.2.2.3.4	Conclusion regarding transparency.....	168
6.2.2.4	Trust income deemed to be that of another	168
6.2.3	By reason of certain factors	171
6.3	Residence under domestic law	175

6.3.1	South Africa.....	175
6.3.1.1	The definition of “resident”	175
6.3.1.2	Incorporated, established or formed	176
6.3.1.2.1	Introduction	176
6.3.1.2.2	Time and place of establishment or formation.....	178
6.3.1.3	POEM	182
6.3.1.3.1	The meaning of POEM in the Income Tax Act and DTTs	182
6.3.1.3.2	SARS’s view regarding the meaning of POEM	184
6.3.1.3.3	Case law and academic views regarding the meaning of POEM.....	187
6.3.1.3.4	Conclusions regarding the meaning of POEM.....	191
6.3.1.4	Is it possible to change a trust’s residence?.....	192
6.3.2	United Kingdom	193
6.3.2.1	The Income Tax Act 2007	193
6.3.2.2	Is it possible to change a trust’s residence?.....	196
6.3.3	Canada.....	197
6.3.3.1	Central management and control	197
6.3.3.2	Income Tax Act	199
6.3.3.3	Is it possible to change a trust’s residence?.....	200
6.3.4	The Netherlands.....	201
6.4	Dual residence and the tiebreaker provision	202
6.4.1	Introduction: Which tiebreaker should be applied and to whom?	202
6.4.2	Concurrent <i>versus</i> consecutive residence and the meaning of “residence” in terms of article 4(3)	205
6.4.3	The meaning of POEM in the OECD MTC.....	206
6.4.3.1	The OECD Commentary on article 4(3)	206
6.4.3.2	Cases on the meaning of POEM	207
6.4.3.3	General remarks regarding the meaning of POEM in the OECD MTC	211
6.4.4	Who exercises the effective management of a trust?.....	213
6.5	Conclusion.....	219
6.5.1	General.....	219
6.5.2	Transparency and the “liable to tax” requirement.....	220
6.5.3	The requirement “by reason of” certain criteria	221

6.5.4	Domestic law.....	221
6.5.5.	The tiebreaker: POEM.....	222
6.5.6	The residence of a trust: the different states	223
6.5.7	Closing remarks.....	224
CHAPTER 7: CONFLICTS OF ATTRIBUTION OF INCOME IN RELATION TO TRUSTS		226
Chapter overview		226
7.1	Introduction	227
7.2	Review of the attribution of trust income	229
7.2.1	South Africa.....	229
7.2.2	United Kingdom	230
7.2.3	Canada.....	230
7.2.4	The Netherlands.....	230
7.2.5	Conclusion.....	231
7.3	Examples	231
7.3.1	Income sourced in one state, but trust, trustee, beneficiaries and settlor resident in the other state	231
7.3.2	Income attributed to another	234
7.3.3	Other selected examples	235
7.4	Possible solutions to conflicts of attribution	237
7.4.1	Should conflicts of attribution be resolved?.....	237
7.4.2	Approach similar to that of the Partnership Report.....	238
7.4.3	Tiebreaker	240
7.4.4	Attribution according to source state	240
7.4.5	Autonomous attribution	241
7.4.6	Conclusion.....	241
7.5	Application of the approach similar to that of the Partnership Report to trusts.....	241
7.5.1	Income sourced in one state, trust, trustee, beneficiaries and settlor resident in the other state	241
7.5.2	Income attributed to another	243
7.5.3	Other selected examples	243
7.6	Conclusion.....	245

CHAPTER 8: BENEFICIAL OWNERSHIP AND A TRUST 247

Chapter overview 247

8.1	Introduction	248
8.2	Difficulties surrounding the interpretation of beneficial ownership	250
8.2.1	Domestic law meaning in accordance with the context of the DTT?	250
8.2.1.1	South Africa	253
8.2.1.2	United Kingdom	256
8.2.1.3	Canada	258
8.2.1.4	The Netherlands	259
8.2.2	Other difficulties	260
8.3	The OECD Commentary on the meaning of beneficial ownership	260
8.4	Case law on the meaning of beneficial ownership	264
8.5	Views of academic authors on the meaning of beneficial ownership	273
8.6	Can a trust (or a trustee) be a beneficial owner?	276
8.6.1	The views of academic authors	276
8.6.2	The case law	279
8.6.3	OECD revised proposals: October 2012	280
8.6.4	Conclusion regarding the question whether a trust can be a beneficial owner	284
8.7	Conclusion	287
8.7.1	General	287
8.7.2	Can a trust be the beneficial owner of income?	289
8.7.3	The different states	290
8.7.4	Closing remarks	290

Annexure to Chapter 8 291

CHAPTER 9: CONCLUSION 295

Chapter overview 295

9.1	Introduction	296
9.2	Nature and key features of a trust	296
9.3	The taxation of trusts	297
9.4	The interpretation and status of tax treaties	298
9.5	Is the trust a person for purposes of the OECD MTC?	299

9.6	The residence of a trust for purposes of the OECD MTC	301
9.7	Attribution of income to a trust	305
9.8	Beneficial ownership and the trust.....	306
9.9	The trust and the OECD MTC from a South African perspective.....	308
9.10	Examples	309
9.11	Closing remarks.....	312
BIBLIOGRAPHY		313

CHAPTER 1

INTRODUCTION

Chapter overview	1
1.1 Background	2
1.1.1 Trusts and their use	2
1.1.2 Double taxation and the OECD Model Tax Convention on Income and on Capital	2
1.2 The main research question	3
1.3 Examples	4
1.4 Methodology	4
1.5 Scope of the dissertation	6
1.6 Brief overview of the existing literature regarding the application of the OECD MTC to trusts	8
1.7 Overview of the content of the dissertation	9

1.1 Background

1.1.1 Trusts and their uses

Trusts are widely used in legal and commercial practice, not only in South Africa, but across the world.¹ Trusts are used for a wide variety of purposes, which range from the more traditional uses, such as the protection of assets or the housing of charities, to more contemporary uses, such as the use of trusts as investment platforms, in black economic empowerment structures (in South Africa) or corporate group reorganisations.²

Like so many other entities, trusts often do not function only in one jurisdiction. Globalisation has led not only to the escalation of cross-border transactions, but also to an increase in the mobility of individuals, resulting in the internationalisation of their investments. Trusts are therefore being used more and more in international transactions.³

One of the difficulties encountered when dealing with trusts in an international setting, is finding an internationally accepted definition of what a trust is.⁴ This difficulty is explained by the fact that “the trust is first and foremost a creature of a national legal system”.⁵ To address this point, this dissertation will examine its topics from the viewpoint of the domestic law of South Africa and three other jurisdictions (the United Kingdom, Canada and the Netherlands). Although the point will be discussed later in greater detail,⁶ it is important to note at this stage that South Africa has developed a unique trust law that is quite unlike the law governing the traditional common law trust.

1.1.2 Double taxation and the OECD Model Tax Convention on Income and on Capital

The problem of international double taxation is often encountered when an entity operates internationally or when international transactions are entered into. International double taxation occurs when the same taxpayer is taxed on the same taxable income by two or more states, or the same taxable income is taxed by two or more states in the hands of different taxpayers.⁷ Double taxation deters international trade and therefore states often

¹ Cadesky in *Trusts and International Tax Treaties* 1. Exactly how important trusts are in the life of citizens (both corporate and individual) in jurisdictions that recognise trusts, is illustrated by Gaillard, who stated that the trust was more important to English life than tea and more important to Americans than baseball (Gaillard was referred to by Lyons in *Topical Analysis* para 3.1). Adapting this metaphor for South African purposes, it may be said that the trust is more important to South Africans than a *braai* (barbeque).

² See, eg, Cadesky in *Trusts and International Tax Treaties* 1, Honiball and Olivier *The Taxation of Trusts in South Africa* vii; Chamberlain and Whitehouse *Trust Taxation* para 2.01; Moffat *et al Trusts Law* 33–34 and Cameron *et al Honoré's South African Law of Trusts* 14–17, who all list uses of trusts.

³ Lyons in *Topical Analysis* para 1; Cadesky in *Trusts and International Tax Treaties* 1; Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 1.

⁴ The definition in the Convention on the Law Applicable to Trusts and on their Recognition art 2 of course provides an example of an “international” definition. For more detail regarding this definition, see ch 2.3.2.1.

⁵ Lyons in *Topical Analysis* para 2.1.

⁶ See ch 2.2.1 and ch 2.2.4.

⁷ Double taxation may be divided into two kinds, namely juridical double taxation and economic double taxation. This distinction is discussed in ch 7.4.1.

employ measures to counter this problem.⁸ One of the measures that a state may use to mitigate international double taxation is to enter into a double taxation treaty (DTT)⁹ with another state.¹⁰ A DTT is an agreement between two or more countries for the avoidance of double taxation of income and capital.¹¹

The Organisation for Economic Co-operation and Development (the OECD) has drafted a Model Tax Convention on Income and on Capital (the OECD MTC),¹² which has, as its main purpose, “to clarify, standardise, and confirm the fiscal situation of taxpayers who are engaged in commercial, industrial, financial, or any other activities in other countries through the application by all countries of common solutions to identical cases of double taxation”.¹³ Although the OECD MTC is not an international treaty and the members of the OECD are not bound to use it when negotiating DTTs, the OECD MTC is very influential and the vast majority of DTTs entered into uses the OECD MTC as basis.¹⁴

In accordance with its own constitution and public international law, each state may impose its own tax law. DTTs patterned on the OECD MTC recognise this, but then operate to restrict a contracting state’s tax claim.¹⁵ The OECD MTC therefore contains a number of rules (known as “distributive rules”) which apply to particular items of income and which allocate the taxing rights in respect of these items between the two states. The OECD MTC contains 31 provisions in total, which include provisions regarding the scope of the Convention (for example article 1, which deals with personal scope), definitions (for example article 4, which deals with residence) and provisions that eliminate double taxation (for example article 23).

1.2 The main research question

The question that this dissertation aims to address is how a court would interpret and apply certain critical provisions of a DTT, patterned on the OECD MTC and to which South Africa is a party, to a trust.

Since the trust governed by South African law is a unique creature, the application of the OECD Model to it will differ from its application to other entities such as companies and trusts found in other jurisdictions.

⁸ OECD *Introduction to OECD Model Tax Convention on Income and on Capital* para 1; Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para B.09; Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 13.

⁹ The term “double taxation treaty” is used in this dissertation, but it is submitted that this term is synonymous with “double taxation convention” and “double taxation agreement”. The term is sometimes shortened to refer only to “treaty”.

¹⁰ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para B.09–B.10; Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 43–44.

¹¹ Larking *IBFD International Tax Glossary* 411.

¹² For a more detailed discussion of the OECD as organisation and the OECD MTC, see ch 4.2.

¹³ OECD *Introduction to OECD Model Tax Convention on Income and on Capital* para 2.

¹⁴ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* paras A.07 and A.11; Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 157–159; OECD *Introduction to OECD Model Tax Convention on Income and on Capital* paras 12–15.

¹⁵ Vogel *et al* *Klaus Vogel on Double Taxation Conventions* 26.

1.3 Examples

Some of the issues that arise from the research question may be highlighted through a number of examples.

- 1.3.1 Assume that an *inter vivos* trust instrument is signed in South Africa between the settlor and the trustees. Assume further that the settlor and trustees agree that South African law will apply to their agreement. The trustees are all Canadian residents. They fulfil their duties as trustees in Canada and all trustee meetings take place in Canada. The trust receives income from a South African source. Assume, first, that the trust is either a vesting trust or a discretionary trust that distributes all of its income to its beneficiaries during the relevant year and that all of the beneficiaries are resident in Canada. Assume then that the beneficiaries are resident in South Africa (and not in Canada). As an alternative, assume that the trust is a discretionary trust that accumulates its income and as a further alternative, assume that the trusts's settlor is resident in the Netherlands.
- 1.3.2 Assume that a trust is resident in South Africa in terms of South African domestic law and in terms of the relevant DTT. The trust receives income from Canada and is a vesting trust or a discretionary trust that distributes all of its income to its South African resident beneficiary during the relevant year. The example is varied by assuming that the trust is a discretionary trust that accumulates all its income during the relevant year.
- 1.3.3 Assume that the trustee of a vesting trust (and the trust itself) is resident in the United Kingdom. The trust receives income from a South African source, which the trustee mandates to the beneficiary. Assume first that the beneficiary is resident in the United Kingdom and, as an alternative, assume that the beneficiary is resident in Canada.

Examples of the issues that arise are whether the trusts in each of these examples will be regarded as "persons" for purposes of the relevant DTTs. In the first example the place where the trust is resident (for domestic and DTT purposes) will have to be determined. Can a trust be the beneficial owner of income? How will the treaty apply if one state taxes the trust and another the beneficiary? Furthermore, different types of trusts are mentioned in these examples. Will the type of trust influence whether the trust will be regarded as a resident or a beneficial owner, or whether income will be attributed to it?

These are the type of questions which this dissertation sets out to address. These examples will be reverted to in the last chapter of this dissertation and will be used to illustrate how the principles set forth in this dissertation will be applied.

1.4 Methodology

The research in this dissertation is conducted by analysing the applicable legislation, case law, academic literature, the Commentary on the OECD MTC and other OECD Reports and materials.

As alluded to earlier, this dissertation also involves comparative research. Although the focus of the dissertation is on the South African position, it is compared to the position in three other states, namely the United Kingdom, Canada and the Netherlands. Each of these states was chosen for specific reasons:

- (a) The United Kingdom was chosen, firstly, because the common law trust originated in England and, of course, still exists and is widely used today. Also, the South African trust has its historical roots in England. Furthermore, the Scottish trust is also found in the United Kingdom. As will become apparent later in this dissertation, there are remarkable similarities between the Scottish trust and the South African trust, both of which are based on civilian principles.¹⁶ Moreover, there is a strong tradition in South African case law of looking to English cases for guidance in formulating South African tax principles. Some of the cases in the United Kingdom on the meaning of a number of the terms in the OECD MTC may therefore be valuable authority in establishing the South African position.¹⁷
- (b) Canada¹⁸ was chosen because it has a well-developed law of trusts involving both trusts established in terms of civilian principles (in Québec)¹⁹ and common law trusts (in the rest of Canada). Furthermore, Canada has a vast network of tax treaties which generally follows the OECD MTC. Moreover, Canadian case law, legislation or DTTs may provide guidance for the position that South Africa might take on points that are still uncertain.
- (c) Although the Netherlands does not have an institution like the trust as such, it is a useful jurisdiction for comparative purposes because of its vast network of DTTs and its wealth of material on that topic. Of particular interest is how a system, which is unfamiliar with trusts, but which is bound to recognise trusts, regards them for purposes of DTTs.

Furthermore, these jurisdictions were chosen because, along with South Africa, they represent the three systems²⁰ most commonly used by states to tax trusts.

In this dissertation, the chapters on trust law²¹ and the taxation of trusts²² are arranged by jurisdiction. Thus, the different topics of trust and tax law that are addressed are discussed

¹⁶ See ch 2.7.

¹⁷ The United Kingdom and Canada were also chosen because in both these jurisdictions not only common law trusts exist, but also trusts based on civilian principles. The Scottish trust and Québec trust, like the South African trust, are based on civilian principles. When the research for this dissertation commenced, it was hoped that the treatment of Scottish and Québec trusts by the United Kingdom and Canada respectively would provide guidance to South Africa on how to apply the relevant provisions of the OECD MTC to its trusts. As it turned out, there was virtually no literature available which specifically addressed the application of the OECD MTC to Scottish and Québec trusts.

¹⁸ One could ask why Canada was chosen, instead of its North American neighbour, the United States of America (USA), one of the major economies in the world. Because of the federal system in the USA, each state has a different set of laws governing entities like trusts. One would therefore have to choose a specific state for comparative purposes, which would introduce an element of arbitrariness and would make the comparative exercise somewhat artificial.

¹⁹ See fn 17.

²⁰ See ch 3.1.

²¹ Ch 2.

under the heading for each particular jurisdiction. The purpose of this methodology is to provide the full picture in respect of each jurisdiction. The remainder of the chapters²³ (save for the conclusion²⁴) are arranged differently. In these chapters, the relevant provisions of the OECD MTC are analysed and discussed. Thus, the relevant criteria set out in the provisions of the OECD MTC, matters regarding their interpretation and the views of courts and academic authors are discussed in a systematic way, referring to each of the chosen states, where applicable. The reason for the change in methodology is to allow for a discussion of some general points under each provision or criterion. The conclusion to each of these chapters will contain a per state discussion of the relevant points addressed in the chapter, in order to provide an overview of each relevant state.

1.5 Scope of the dissertation

There are many challenges and unanswered questions that should be addressed when examining the application of the OECD MTC to trusts. For a number of reasons, this dissertation cannot address all of these points. The first reason deals with the nature of the trust. Trusts are extremely versatile entities, used for many purposes worldwide. They are also very flexible and the powers and obligations that trustees might have, span an exceptionally wide range.²⁵ To address all of these possibilities in this dissertation would be impossible. More practically, this dissertation must be kept within certain acceptable limits and therefore its scope must be limited. Moreover, the dissertation is written from a South African perspective and the focus will fall on the South African position throughout. Reference will be made to the chosen jurisdictions in order to show how they have addressed certain issues with a view to providing guidance on how the South African position may be interpreted, addressed or improved.

This dissertation will address only certain critical provisions in the OECD MTC. Provisions that deal with the applicability of the OECD MTC to trusts were chosen, because if a trust (or trustee) cannot bring itself within these requirements, it cannot rely on a DTT based on the OECD MTC. It is acknowledged that there are many more provisions of the OECD MTC, the application to trusts of which are problematic and deserves further research. For example, the question of whether a trustee or beneficiary of a trust can be a permanent establishment of the trust comes to mind.²⁶ This and other questions regarding the application of the other provisions of the OECD MTC to trusts, fall outside the scope of this dissertation. Furthermore, in respect of those provisions that are addressed in this dissertation, the alternative provisions contained in the Commentary are not addressed.²⁷

²² Ch 3.

²³ Ch 4 to ch 8.

²⁴ Ch 9.

²⁵ Wheeler (2011) 3 *World Tax Journal* 247 343–344.

²⁶ As stated in this paragraph, business trusts will not be addressed in this dissertation. Hence, the view was taken that the application of articles 5 and 7 of the OECD MTC (which deals with permanent establishments and business profits respectively) was not one of the critical provisions that should be addressed.

²⁷ Eg, the Commentary to article 4(3) provides for an alternative provision which refers to the mutual agreement procedure to determine where an entity will be resident for treaty purposes in the case of dual residence.

Not all types of trusts can be addressed in this dissertation.²⁸ The focus of this dissertation falls on trusts in the narrow sense,²⁹ that are expressly created and that primarily hold assets that generate income. Therefore, special types of trusts, some of which are regulated by specific legislation, such as unit trusts (also known as collective investment schemes or trusts), mutual fund trusts, pension schemes and employee share trusts, are not addressed. Furthermore, charitable trusts fall outside the scope of the dissertation. Trusts to which a special tax regime applies, for example trusts in favour of minors, are also not addressed and neither are business or commercial trusts.

Moreover, this dissertation discusses only income tax. Capital gains tax is not addressed. In addition, other taxes, such as estate or death duty, value-added tax and the like, are excluded. Even though income tax is addressed, the dissertation will not discuss whether an amount is of a capital or income nature and it is assumed that it is of an income nature, unless specifically stated otherwise. Furthermore the taxation of remuneration of a trustee is not examined.

The effects of exchange differences are ignored in this dissertation and so too are any exchange control measures.

During his 2013 Budget Speech, the South African Minister of Finance, announced that the taxation of trusts will be reviewed in order to control abuse.³⁰ Although the Budget Review documentation³¹ provided some clues as to what the reforms might entail, it was clear that the review process was still in its early stages and that the reforms were still being shaped. Since the Budget Speech, National Treasury has indicated that the changes regarding the taxation of trusts have not been finalised. No discussion document or draft legislation has been issued and the hope has been expressed that the Davis Tax Committee³² will consider

²⁸ Further types of trusts that are excluded from the scope of this dissertation are referred to in ch 2, where they (and the reasons for their exclusion) are briefly mentioned under each jurisdiction.

²⁹ A distinction may be drawn between trusts in the wide sense and trusts in the strict or narrow sense. A trust in the wide sense exists "whenever someone is bound to hold or administer property on behalf of another or for some impersonal object and not for his or her own benefit". Curators of persons suffering from intellectual incapacity and agents are examples of trusts in the wide sense. By contrast, a trust in the narrow sense exists "when the creator or founder of the trust has handed over or is bound to hand over to another the control of property which, or the proceeds of which, is to be administered or disposed of by the other (the trustee or administrator) for the benefit of some person other than the trustee as beneficiary, or for some impersonal object" (Cameron *et al* *Honoré's South African Law of Trusts* 4).

³⁰ Minister of Finance "Budget Speech"

<<http://www.treasury.gov.za/documents/national%20budget/2013/speech/speech.pdf>> (accessed on 18/02/2014).

³¹ Minister of Finance "Budget Review"

<<http://www.treasury.gov.za/documents/national%20budget/2013/review/chapter%204.pdf>> (accessed on 18/02/2014).

³² The Minister of Finance announced during his 2013 Budget Speech that the South African tax policy framework would be reviewed. A committee under the chairmanship of Judge Dennis Davis was formed to conduct the review process. See The Davis Tax Committee "Introduction" <<http://www.taxcom.org.za/index.html>> (accessed on 18/02/2014).

the taxation of trusts as part of their mandate.³³ Since these reforms are clearly in a very early phase, they are not discussed in this dissertation.

1.6 Brief overview of the existing literature regarding the application of the OECD MTC to trusts

The seminal work on the treatment of trusts under the OECD MTC is the article by Avery Jones.³⁴ Baker's acclaimed text book³⁵ points to a number of questions that arise in relation to trusts and the OECD MTC and addresses some of the points examined in this dissertation. Danon's dissertation on Switzerland's direct and international taxation of private express trusts contains a number of chapters on the treatment of trusts under Swiss DTTs with three other jurisdictions.³⁶ In an article dealing with Australian and New Zealand trusts, Prebble offers a discussion of the residence of trusts as well as the beneficial ownership requirement.³⁷ A chapter in a Canadian study also provides a brief overview of the problems encountered in the application of the OECD MTC to trusts.³⁸ Furthermore, a chapter on trusts and the OECD MTC was written by Koele, in which issues such as residence and beneficial ownership are addressed.³⁹ Wheeler has made a number of contributions which refer to different problems regarding the application of the OECD MTC to trusts, most notably on the attribution of income.⁴⁰

Many of these contributions served as extremely useful bases from which to conduct the research undertaken in this dissertation. They provided valuable guidance in many instances, as will appear from the many references to them in this dissertation. However, none of these contributions includes South Africa in its scope and therefore the position of the South African trust remains largely unexplored. Furthermore, several of these contributions were published some time ago⁴¹ and many developments have taken place since their publication. A number of these contributions also provide only an overview of some of the issues involved in the application of the OECD MTC to trusts and a more in-depth examination of these issues is therefore required.

³³ Croome "The Future Taxation of Trusts"

<http://www.ensafrica.com/Uploads/Images/news/2_August_2013_-_The_Legal_Times_-_The_future_taxation_of_trusts_.pdf> (accessed on 18/02/2014).

³⁴ Avery Jones (1989) 2 *BTR* 41 and Avery Jones (1989) 3 *BTR* 65.

³⁵ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* paras 1B.17–1B.28. See also Baker in *Trusts and International Tax Treaties* ch 16, in which he suggests some principles and a possible approach to the application of DTTs to trusts.

³⁶ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* part IV ch 1 to ch 3.

³⁷ Prebble (2004) 2 *eJournal of Tax Research*. See also Prebble (2008) VIII *Trusts and Tax Treaties* 75.

³⁸ Carrothers in *Trusts and International Tax Treaties* ch 12.

³⁹ Koele in *The Trust: Bridge or Abyss between Common and Civil Law Jurisdictions* ch 7.

⁴⁰ Wheeler (2005) 59 *BFIT* 477, Wheeler in *Cahiers de Droit Fiscal International: Conflicts in the Attribution of Income to a Person*; Wheeler in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law*; Wheeler (2011) 3 *World Tax Journal* 39; Wheeler (2011) 3 *World Tax Journal* 247.

⁴¹ Eg, Avery Jones and Koele's contributions were published more than twenty years ago and Prebble and Danon's contributions ten years ago.

In South Africa, the two textbooks by Olivier and Honiball contain a chapter and a portion of a chapter, respectively, on the application of DTTs to trusts.⁴² Although these two contributions certainly constitute pioneering work, a more comprehensive and detailed investigation of the relevant aspects of the application of the OECD MTC to trusts is undertaken in this dissertation.

The aim of this dissertation is to increase the existing knowledge regarding the interpretation and application of the OECD MTC in South Africa, specifically in relation to trusts.

1.7 Overview of the content of the dissertation

The dissertation starts off with a discussion of the definition, nature and key features of a trust in each jurisdiction. The nature of a trust impacts not only on how it (or the parties thereto) will be taxed, but also on the way in which it will be treated in terms of each state's DTTs. It is therefore crucial to examine the trust law of each jurisdiction, a task that is undertaken in chapter 2.

In the next chapter, an overview will be given of the way in which each state taxes trusts (and the parties thereto). The chapter will provide the required background for the discussion of the application of certain provisions of the OECD MTC to trusts in later chapters.

Chapter 4 addresses the interpretation and status of DTTs in each of the jurisdictions. These aspects influence the manner in which each state applies its DTTs to trusts and it is therefore crucial that they be investigated and be borne in mind throughout the rest of the dissertation.

In order for a trust (or trustee) to rely on a DTT based on the OECD MTC, it must be shown that it is not only a person, but also a resident of one or both of the contracting states. The question whether a trust (or trustee) is a person, is addressed in chapter 5, while the residence of a trust is examined in chapter 6.

Chapter 7 analyses how income is attributed to a trust (or trustee) in each of the jurisdictions and provides examples of how a conflict of attribution will be dealt with between the chosen jurisdictions.

Beneficial ownership is addressed in chapter 8. The main question posed in this chapter is whether a trust (or the trustee) can be regarded as the beneficial owner of income.

Chapter 9 constitutes the conclusion to this dissertation. The chapter collates the findings and recommendations of the dissertation and endeavours to answer the research question set out above. The conclusions of the dissertation are also applied to the examples referred to earlier.

⁴² Honiball and Olivier *The Taxation of Trusts in South Africa* ch 12 and Olivier and Honiball *International Tax: a South African Perspective* ch 5 para 5.

CHAPTER 2

THE DEFINITION, NATURE AND KEY FEATURES OF A TRUST

Chapter overview	10
2.1 Introduction	12
2.2 South Africa	12
2.2.1 A brief history	12
2.2.2 Legal basis for the reception of the trust	13
2.2.3 Definitions	14
2.2.4 Legal nature and key features	16
2.2.5 Requirements for the formation of a valid trust	21
2.2.6 Administration of a trust	23
2.3 United Kingdom	24
2.3.1 A brief history	24
2.3.1.1 General	24
2.3.1.2 England	24
2.3.1.3 Scotland	26
2.3.2 Definitions	27
2.3.2.1 England	27
2.3.2.2 Scotland	29
2.3.3 Legal nature and key features	29
2.3.3.1 England	29
2.3.3.2 Scotland	32
2.3.4 Requirements for the formation of a valid trust	35
2.3.4.1 England	35
2.3.4.2 Scotland	38
2.3.5 Administration of a trust	39
2.3.5.1 England	39
2.3.5.2 Scotland	40
2.4 Canada	41
2.4.1 Introduction	41

2.4.2	A brief history	42
2.4.2.1	The rest of Canada	42
2.4.2.2	Québec	42
2.4.3	Definitions	43
2.4.3.1	The rest of Canada	43
2.4.3.2	Québec	44
2.4.4	Legal nature and key features	45
2.4.4.1	The rest of Canada	45
2.4.4.2	Québec	47
2.4.5	Requirements for the formation of a valid trust	49
2.4.5.1	The rest of Canada	49
2.4.5.2	Québec	50
2.4.6	Administration of a trust	51
2.4.6.1	The rest of Canada	51
2.4.6.2	Québec	52
2.5	The Netherlands	52
2.5.1	Introduction	52
2.5.2	Accent to the Hague Convention on Trusts	54
2.6	OECD MTC	55
2.7	Conclusion	55

2.1 Introduction

This chapter will discuss certain aspects of trust law in each of the chosen jurisdictions. In order to provide the required background, a brief history of trusts in each jurisdiction will be provided. Thereafter the definitions, nature and key features of a trust in each of the jurisdictions will be discussed. Also, the requirements of a valid trust as well as certain aspects regarding the administration of a trust will be dealt with. The treatment of trusts in the Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital (the OECD MTC) will be dealt with briefly and, lastly, certain conclusions will be reached.

2.2 South Africa

2.2.1 A brief history

The trust first made its appearance in South Africa in the early nineteenth century when British settlers and officials used the word “trust” in wills, deeds of gift, antenuptual contracts and land transfers. The trust that they used was, of course, the English trust.⁴³ The first reported case in which a trust is mentioned was decided in 1833.⁴⁴ Certain statutes made during the nineteenth century in the Cape and in Natal also used the mechanism of a trust and that of trustees.⁴⁵ It has been said that the trust “became a familiar feature of legal and commercial practice at the Cape and ... throughout what was to become modern-day South Africa”.⁴⁶ It was only about a century later that the Appellate Division for the first time pronounced on the validity of the trust. In *Estate Kemp v MacDonald’s Trustee*⁴⁷ the court held that the English law of trusts did not form part of South African law, but that testamentary dispositions couched in the form of trusts could be given effect to.⁴⁸ The court found that the idea of a trust was so firmly rooted in practice in South Africa, that it would be impossible to eradicate it or to seek to abolish it.⁴⁹ Other judgements have confirmed the point that the English law of trusts did not form part of South African law and that South Africa had evolved (and is in the process of still developing) its own unique trust law, based on South African legal principles.⁵⁰

Legislation also played a role, albeit a very modest one, in the development of South African trust law.⁵¹ As is evident from the above, no legislation was involved in the reception of the

⁴³ De Waal (2000) 117 SALJ 548 548; Cameron *et al* *Honoré’s South African Law of Trusts* 21, Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 310.

⁴⁴ Olivier *et al* *Trustreg en Praktyk* 1–17. Coetzee lists a number of cases following this date in which trusts were mentioned or approved (Coetzee ‘*n Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 76-781).

⁴⁵ Cameron *et al* *Honoré’s South African Law of Trusts* 21. See also Coetzee ‘*n Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 74-75.

⁴⁶ Du Toit *South African Trust Law: Principles and Practice* 13.

⁴⁷ *Estate Kemp v MacDonald’s Trustee* 1915 AD 491.

⁴⁸ *Estate Kemp v MacDonald’s Trustee* 1915 AD 491 499.

⁴⁹ *Estate Kemp v MacDonald’s Trustee* 1915 AD 491 508. Confirmed in *Crookes NO v Watson* 1956 1 SA 277 (A) 290.

⁵⁰ *Braun v Blann & Botha NNO* 1984 2 SA 850 (A) 859; *Crookes NO v Watson* 1956 1 SA 277 (A).

⁵¹ Coetzee provides examples of legislation in which trusts were or are acknowledged (Coetzee ‘*n Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 75).

trust into South African law,⁵² but the Trust Moneys Protection Act⁵³ was the first act relevant to trusts in the strict sense and is noted for its requirements regarding the provision of security by trustees.⁵⁴ The Trust Property Control Act⁵⁵ has made a significant impact on the development of trust law in South Africa, although it was never intended that the Trust Property Control Act be regarded as a codification of trust law.⁵⁶ Its aim was to deal with certain problems that had never been resolved by the courts.⁵⁷

2.2.2 Legal basis for the reception of the trust

Although the trust was widely used, uncertainty existed regarding the basis upon which the trust was recognised in South African law. In *Estate Kemp* the court found the *fideicommissum* to be the basis on which testamentary trusts formed part of South African law.⁵⁸ However, in *Braun v Blann and Botha* the Appellate Division held that it is both historically and jurisprudentially wrong to identify the trust with the *fideicommissum* and to equate a trustee to a fiduciary.⁵⁹

Regarding *inter vivos* trusts, the majority of the court in *Crookes NO v Watson*⁶⁰ held that a trust is created by means of a *stipulatio alteri*. In other words, a contract is entered into between the trust settlor⁶¹ (the *stipulans*) and the trustee (the *promittens*) for the benefit of the trust beneficiary (the third party).⁶² The court held that the acceptance by the trustees of the donation and the trust does not amount to an acceptance by them on behalf of the beneficiaries. Their acceptance could merely be construed as an agreement to carry out the provisions of the trust deed.⁶³ On execution of the agreement between the trust settlor and the trustee, the beneficiary obtains no right. The agreement constitutes an offer of a donation by the settlor to the beneficiary, through the acceptance of which the beneficiary obtains a *jus perfectum* against the trustees. Up to the stage of acceptance by the beneficiary, there is no *vinculum juris* between the beneficiary and the settlor or trustees.⁶⁴ Steyn JA, who formed part of the majority held, in his judgement that a trust is brought into operation by the contract between the settlor and the trustees.⁶⁵ The decision in *Crookes v*

⁵² De Waal in *Trusts in Mixed Legal Systems* 50.

⁵³ Trust Moneys Protection Act 34 of 1934.

⁵⁴ Du Toit *South African Trust Law: Principles and Practice* 21.

⁵⁵ Trust Property Control Act 57 of 1988.

⁵⁶ Du Toit *South African Trust Law: Principles and Practice* 21; Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 320.

⁵⁷ De Waal in *Trusts in Mixed Legal Systems* 50.

⁵⁸ *Estate Kemp v MacDonald's Trustee* 1915 AD 491 499.

⁵⁹ *Braun v Blann & Botha NNO* 1984 2 SA 850 (A) 866. See also Coetzee 'n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 90-98.

⁶⁰ *Crookes NO v Watson* 1956 1 SA 277 (A). See also Coetzee 'n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 99-112 for a discussion of this case.

⁶¹ In South Africa, a settlor is usually referred to as the "founder". As the term "settlor" is used in all the other jurisdictions, save for Scotland, which uses the term "truster", and in the Convention on the Law Applicable to Trusts and on their Recognition, this term will be used throughout the dissertation to maintain consistency, even in those jurisdictions which uses other terms.

⁶² Du Toit *South African Trust Law: Principles and Practice* 18.

⁶³ *Crookes NO v Watson* 1956 1 SA 277 (A) 284.

⁶⁴ *Crookes NO v Watson* 1956 1 SA 277 (A) 286.

⁶⁵ *Crookes NO v Watson* 1956 1 SA 277 (A) 305.

Watson was followed in *Hofer v Kevitt*.⁶⁶ *Cameron et al* make the point that an *inter vivos* trust is usually *created* by way of a contract that contains a stipulation in favour of the beneficiary and that the creation and revocation of trusts are therefore regulated by the law of contract. However, trusts are not merely contracts.⁶⁷ Other aspects regarding trusts, such as the fact that a trustee holds an office, or the fiduciary relationship between the trustees and beneficiaries are not covered by the law of contract. A distinction must therefore be made between the creation of an *inter vivos* trust and the trust itself.⁶⁸

2.2.3 Definitions

Numerous definitions of a trust exist. *Cameron et al* define a trust as “a legal institution in which a person, the trustee, subject to public supervision, holds or administers property separately from his or her own, for the benefit of another person or persons or for the furtherance of a charitable or other purpose”.⁶⁹

In the Trust Property Control Act⁷⁰ a trust is defined as follows:

“‘trust’ means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed –

- (a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or
- (b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument,

but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act, 1965 (Act No 66 of 1965).”

In *Land and Agricultural Bank of South Africa v Parker & Others*⁷¹ Cameron JA described a trust as:

“... an accumulation of assets and liabilities. These constitute the trust estate, which is a separate entity. But though separate, the accumulation of rights and obligations comprising the trust estate does not have legal personality. It vests in the trustees, and

⁶⁶ *Hofer v Kevitt* NO 1998 1 SA 382 (SCA).

⁶⁷ *Cameron et al Honoré's South African Law of Trusts* 35; Du Toit *South African Trust Law: Principles and Practice* 19. For a contrary view see Coetzee 'n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 113.

⁶⁸ Du Toit *South African Trust Law: Principles and Practice* 19.

⁶⁹ *Cameron et al Honoré's South African Law of Trusts* 1. For a discussion of a number of these definitions, see Coetzee 'n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 127-135.

⁷⁰ Trust Property Control Act 57 of 1988 s 1.

⁷¹ *Land and Agricultural Bank of South Africa v Parker* 2005 2 SA 77 (SCA) para 10.

must be administered by them – and it is only through the trustees, specified as in the trust instrument, that the trust can act.”

The Income Tax Act⁷² defines a trust as meaning “any trust fund consisting of cash or other assets which are administered and controlled by a person acting in a fiduciary capacity, where such person is appointed under a deed of trust or by agreement or under the will of a deceased person”.⁷³

Clearly the definition of “trust” in the Income Tax Act is much wider than any of the definitions offered in the sources on trust law cited above.⁷⁴ A “trust” for purposes of the Income Tax Act would include, for example, any trust fund administered by a person in a fiduciary capacity, where such person was appointed by agreement. Thus, certain agency relationships would, for example, be covered by the definition of “trust” in the Income Tax Act, but would not be regarded as trusts for trust law purposes.⁷⁵ It is submitted that a trust fund which falls within the definition of “trust” in the Income Tax Act will be taxed as such, even though it will not be classified as a trust for purposes of trust law.

Having reached this conclusion, the question arises how offshore trusts will be treated. In other words, certain offshore trusts will not be regarded as “trusts” for trust law purposes in South Africa, but they will constitute trusts for purposes of the Income Tax Act. Will they be taxed as trusts? A further question that is linked to the first is whether a trust, recognised as such under the trust law of the relevant country, will be regarded as a trust in South Africa for tax purposes, simply because it is a trust in the other relevant country. It is submitted that the answer in all cases will depend on whether the specific entity meets the criteria of the definition in the Income Tax Act. Even if an entity may be classified as a trust in a certain country, whether it will be taxed as a trust in South Africa, will depend on whether it falls within the definition set out in the Income Tax Act. Furthermore, an offshore entity which may not be regarded as a trust for South African trust law purposes, which falls within the definition of trust in the Income Tax Act, will be taxed as a trust.⁷⁶ It is submitted that a court will follow the methodology set out in *Commissioner for Inland Revenue v Estate Greenacre*⁷⁷ where a marriage settlement was made by a person domiciled in South Africa, but the terms

⁷² Income Tax Act 58 of 1962.

⁷³ Income Tax Act 58 of 1962 s 1. The same section also contains a definition of the term “company”. Some offshore trusts, eg certain collective investment vehicles or charitable trusts, may qualify as companies (as defined). Since these types of trusts fall outside the scope of this research, the point will not be addressed any further. If an offshore trust is a juristic person, it may also qualify as a company (as defined). Since trusts are not regarded as juristic persons in any of the jurisdictions discussed in this research, the point will also not be discussed in any greater detail.

⁷⁴ For a discussion regarding the interpretational difficulties associated with the definition in the Income Tax Act, see Du Plessis (2009) 21 *SA Merc LJ* 322 324. Furthermore, De Koker and Williams note that the Income Tax Act’s definition does not refer to trusts created by statute or court order (De Koker and Williams *Silke on South African Income Tax* para 12.14).

⁷⁵ See ch 2.2.4.

⁷⁶ Support for this point may be found in Honiball and Olivier *The Taxation of Trusts in South Africa* 65. Jooste questions whether offshore trusts, which do not have any beneficiaries (but have a particular purpose set out in the trust instrument – a purpose that may bear little resemblance to its true purpose) will qualify as a trust in terms of the definition, as it is not clear whether the trustees of such a trust have fiduciary duties, an essential requirement for a trust in terms of the definition in the Income Tax Act (Jooste (2002) *Acta Juridica* 186 205–206).

⁷⁷ *Commissioner for Inland Revenue v Estate Greenacre* 1936 NPD 225; 8 SATC 196.

of the settlement were governed by the law of England. The person who made the settlement subsequently passed away and the question before the Natal Provincial Division was whether the settlement could be regarded as a *donatio inter vivos* for purposes of the Death Duties Act. The court held that it could consider the law of England in order to determine whether the fulfilment by the deceased of the obligations of a marriage settlement amounted to a *donatio inter vivos* under the law of England. Once it had determined the rights and obligations of the marriage settlement in terms of the law of England, it could then consider whether the marriage settlement constituted a *donatio inter vivos* for purposes of the Death Duties Act. It is, therefore, submitted that a court would consider the trust law of the offshore jurisdiction in order to determine the rights and obligations between the parties and thereafter determine whether these rights fall within the definition of “trust” in the Income Tax Act.

2.2.4 Legal nature and key features

No trust can exist without the settlor handing over control of the trust property or having bound himself or herself to hand over control of the trust property.⁷⁸ Usually the handing over of control of the trust property means that ownership of the trust assets is transferred by the settlor to the trustee. The settlor may be a co-trustee and therefore co-owner of the trust property.⁷⁹ Furthermore, there can be no objection to the settlor being the only trustee (as long as he is not also the only beneficiary).⁸⁰ In South African law it is also possible for a settlor to transfer ownership of trust property directly to the beneficiary.⁸¹ The trustee will then simply administer the property for the benefit of the beneficiary. The trustee, therefore, controls the trust property, of which the beneficiary is the owner.⁸² Such a trust is known as a “bewind” trust and is rarely used in practice.⁸³ For this reason a discussion of the “bewind” trust falls outside the scope of this dissertation.

The ownership of trust property may provide further insight into the nature of the trust. South Africa has what is known as a mixed legal system, meaning that although the basis of South African law is Roman-Dutch law (that is, based on civilian principles), English law has influenced it considerably.⁸⁴ South Africa follows civilian principles in relation to property law and, therefore, recognises the unitary concept of ownership; in other words, there is only one kind of ownership which cannot be divided.⁸⁵ Dual ownership, known in the English law, therefore, does not form part of South African law. In English law the split between legal and equitable ownership is often regarded as the definitive aspect of a trust, with the

⁷⁸ Du Toit *South African Trust Law: Principles and Practice* 9.

⁷⁹ Cameron *et al* *Honoré’s South African Law of Trusts* 6; Du Toit *South African Trust Law: Principles and Practice* 6.

⁸⁰ Cameron *et al* *Honoré’s South African Law of Trusts* 6.

⁸¹ Trust Property Control Act 57 of 1988 s 1 para (b) of the definition of “trust”.

⁸² Du Toit *South African Trust Law: Principles and Practice* 4.

⁸³ Cameron *et al* *Honoré’s South African Law of Trusts* 9; De Waal in *Trusts in Mixed Legal Systems* 77; Du Toit *South African Trust Law: Principles and Practice* 4.

⁸⁴ De Waal in *Trusts in Mixed Legal Systems* 43.

⁸⁵ De Waal in *Trusts in Mixed Legal Systems* 44.

trustee holding “legal ownership” of the trust property and the beneficiary “beneficial ownership”.⁸⁶

With regards to the ownership of trust property, the courts in South Africa have held that the legal ownership of the property lies in the hands of the trustees, who have no beneficial interest in it. They are, however, bound to hold and apply the trust property for the benefit of a person(s) or for some other purpose.⁸⁷ South African courts have explicitly decided that the notion of dual ownership known in the English law does not form part of South African law.⁸⁸ The trustee is the owner of the trust assets and the beneficiaries merely have personal rights against the trustee. Therefore the unitary concept of ownership remains intact.⁸⁹ However, a beneficiary is often said to have the “beneficial ownership” of, or the “beneficial interest” in the trust property, whilst the trustee is said to be the “legal owner” of the trust property.⁹⁰ While this terminology may be useful to explain the legal relationship between the trustee and beneficiary, it might, unfortunately, create confusion with its different use in the context of English law.

One of the reasons for the dual ownership of trustee and beneficiary in English law is the protection of the trust beneficiary.⁹¹ For example, a beneficiary is protected against the insolvency of the trustee, because the beneficiary’s equitable ownership in the trust property prevents it from forming part of the trustee’s patrimony.⁹² In South African law, the resort to dual ownership is unnecessary as the Trust Property Control Act provides that:

“Trust property shall not form part of the personal estate of the trustee except in so far as he as the trust beneficiary is entitled to the trust property.”⁹³

The Trust Property Control Act furthermore places a duty on the trustee to make trust property identifiable as such.⁹⁴

Hence, in the case of insolvency of the trustee, the beneficiaries are protected as the trustee’s creditors have no rights to the trust assets. Similarly, a beneficiary has no claim against the trustee’s private estate (save in the case of breach of trust).⁹⁵ The Trust Property Control Act thus recognises that two different estates are created: one for the trustee’s

⁸⁶ De Waal (2000) 117 SALJ 548 550; De Waal (2001) 12 Stell LR 63 64; Sonneveldt in *The Trust: Bridge or Abyss between Common and Civil Law Jurisdictions?* 1.

⁸⁷ *Estate Kemp v MacDonald’s Trustee* 1915 AD 491 508; *Braun v Blann & Botha NNO* 1984 2 SA 850 (A) 859; Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 312.

⁸⁸ *Braun v Blann & Botha NNO* 1984 2 SA 850 (A) 859.

⁸⁹ De Waal in *Trusts in Mixed Legal Systems* 48; De Waal (2001) 12 Stell LR 63 76.

⁹⁰ *Braun v Blann & Botha NNO* 1984 2 SA 850 (A) 859–860; *Yarram Trading CC t/a Tijuana Spur v ABSA Bank Ltd* 2007 2 SA 570 (SCA) 576; Cameron *et al* *Honoré’s South African Law of Trusts* 579. According to Olivier *et al* these expressions are senseless (Olivier *et al* *Trustreg en Praktyk* 1–10).

⁹¹ De Waal (2000) 117 SALJ 548 557; De Waal (2001) 12 Stell LR 63 67. See also Coetzee ‘n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 57.

⁹² De Waal in *Trusts in Mixed Legal Systems* 560.

⁹³ Trust Property Control Act 57 of 1988 s 12.

⁹⁴ Trust Property Control Act 57 of 1988 s 11.

⁹⁵ De Waal (2000) 117 SALJ 548 562.

personal assets and one for the trust assets held by the trustee in his or her capacity as such.⁹⁶

According to Cameron *et al*, the Trust Property Control Act therefore confirms that the trust is a separate entity, although it is not a juristic person.⁹⁷ A beneficiary has a “protected” right *in personam* against the trustee, as the beneficiary does not have to compete with the trustee’s private creditors for the trust assets.⁹⁸

Some theorists have argued that the trust property is owned by the trust estate itself, which would mean that the trust was a juristic person.⁹⁹ South African courts have, however, rejected such a contention on numerous occasions, confirming that a trust is not a juristic person and does not have juristic personality, except as provided for in statute.¹⁰⁰ There are, however, many instances where trusts are treated as juristic persons.¹⁰¹ For example, for purposes of insolvency, the trust assets are regarded as distinct from the trustees’ personal assets;¹⁰² a bequest to an existing *inter vivos* trust is valid and will be regarded as a bequest to the trustees for purposes of the trust.¹⁰³ Notably, a trust is treated as though it were a juristic person for income tax purposes.¹⁰⁴ The Companies Act¹⁰⁵ includes a trust in its definition of juristic person. The reasons for treating the trust as a juristic person are diverse.¹⁰⁶

South African courts have held that both testamentary and *inter vivos* trusts should be regarded as *sui generis* institutions.¹⁰⁷ However, such a characterisation of trusts has been criticised as being confusing and unsound from a theoretical and dogmatic point of view. It is argued that theoretical soundness is desirable to preserve the integrity of the trust.¹⁰⁸

⁹⁶ Du Toit *South African Trust Law: Principles and Practice* 9.

⁹⁷ Cameron *et al* *Honoré’s South African Law of Trusts* 11.

⁹⁸ Cameron *et al* *Honoré’s South African Law of Trusts* 559.

⁹⁹ Cameron *et al* *Honoré’s South African Law of Trusts* 9; Olivier *et al* *Trustreg en Praktyk* 2–32.

¹⁰⁰ *Commissioner for Inland Revenue v MacNeillie’s Estate* 1961 3 SA 833 (A); *Commissioner for Inland Revenue v Friedman and Others* NNO 1993 1 SA 353 (A); *Land and Agricultural Bank of South Africa v Parker* 2005 2 SA 77 (SCA); *Thorpe v Trittenwein* 2007 2 SA 172 (SCA). Judgments to the contrary, eg *Knoop NNO v Birkenstock Properties (Pty) Ltd* Unreported judgment of the Free State High Court, 4 June 2009, Case No. : 7095/2008, are clearly wrong and should be rejected.

¹⁰¹ De Waal (1993) 56 *THRHR* 1 8; Cameron *et al* *Honoré’s South African Law of Trusts* 10; Du Toit *South African Trust Law: Principles and Practice* 25.

¹⁰² The Trust Property Control Act 57 of 1988 s 12, provides that trust property shall not form part of the personal estate of the trustee except in so far as he as trust beneficiary is entitled to the trust property. Trust assets, therefore, do not form part of an insolvent trustee’s estate. In *Magnum Financial Holdings (Pty) Ltd (In Liquidation) v Summerly and Another* NNO 1984 1 SA 160 (W) it was held that a trust is a “debtor” and can be sequestrated.

¹⁰³ Cameron *et al* *Honoré’s South African Law of Trusts* 71.

¹⁰⁴ The Income Tax Act, s 1, definition of “person”.

¹⁰⁵ Companies Act 71 of 2008.

¹⁰⁶ De Waal (1993) 56 *THRHR* 1 9.

¹⁰⁷ *Braun v Blann & Botha* NNO 1984 2 SA 850 (A) 859; *Mariola v Kaye-Eddie* NO 1995 2 SA 728 (W) 731; *Rosner v Lydia Swanepoel Trust* 1998 2 SA 123 (W) 126; *Cupido v Kings Lodge Hotel* 1999 4 SA 257 (E) 263; *Scania South Africa (Pty) Ltd v Smit* 2003 1 SA 457 (T) 464; *Desai-Chilwan NO v Ross* 2003 2 SA 644 (C) 647.

¹⁰⁸ De Waal (1993) 56 *THRHR* 1 9; Du Toit *South African Trust Law: Principles and Practice* 18.

As stated in Cameron *et al*'s definition, a trust is a legal institution and subject to public supervision.¹⁰⁹ A trustee of a trust therefore holds an office, which is a feature that distinguishes a trust from many other private law institutions.¹¹⁰ Importantly, a trustee is not an agent of, specifically, the settlor, the beneficiaries or the trust itself;¹¹¹ nor is the trustee a nominee of the beneficiaries.¹¹² The public element brought about by the fact that the trustee holds an office, is illustrated by the role that the court plays in the administration and execution of trusts. For example, a court may, under certain circumstances, appoint or remove a trustee.¹¹³ Moreover, the Trust Property Control Act provides that the Master of the High Court has certain supervisory powers over trustees.¹¹⁴

One of the characteristics of the position of trustee is that it gives rise to a fiduciary duty. A trustee's fiduciary duty has been described as "a single, multifaceted duty comprised of a number of component duties".¹¹⁵ The facet relevant in any given situation will depend on the relationship between the parties and the facts of each case. According to Du Toit, the principal components of a trustee's fiduciary duty are the duty of care, the duty of impartiality, the duty of accountability and the duty of independence. However, he emphasises that the ambit of a fiduciary duty is not cast in stone and that more duties may be added.¹¹⁶ Cameron *et al* highlight three "main principles" which govern the administration of trusts, namely that the trustee must give effect to the trust instrument, that the trustee must act with the "care diligence and skill which can reasonably be expected of a person who manages the affairs of another",¹¹⁷ and that the trustee has the duty to exercise an independent discretion.¹¹⁸ Olivier *et al* describe the trustee's fiduciary duty as one in which the highest degree of faithfulness and loyalty is required in fulfilling his or her duties for the benefit of the beneficiaries. They continue that a trustee must act as a *bonus paterfamilias* and that he should act honourably and without the motive to favour himself or herself and in accordance with the requirements of good faith.¹¹⁹

An aspect of trust law that was emphasised by the court in *Land and Agricultural Bank of South Africa v Parker*¹²⁰ is the importance of separating ownership (or control) and enjoyment. The court highlighted the principle that trustees exercise control over the trust assets, not for their own benefit, but for the benefit of others, namely the beneficiaries. It is for this reason that a person cannot be both the sole trustee and the sole beneficiary of a trust. Such an identity of interests is impermissible and no valid trust would come into existence. In *Nel v Metequity Ltd*¹²¹ the question of separation of ownership and control was

¹⁰⁹ See also *Land and Agricultural Bank of South Africa v Parker* 2005 2 SA 77 (SCA) para 34.

¹¹⁰ Cameron *et al* *Honoré's South African Law of Trusts* 5; De Waal (2000) 117 SALJ 548 566.

¹¹¹ Cameron *et al* *Honoré's South African Law of Trusts* 73; *Hoosen and Others NNO v Deedat* 1999 4 SA 425 (SCA) 431.

¹¹² Cameron *et al* *Honoré's South African Law of Trusts* 69.

¹¹³ De Waal (2000) 117 SALJ 548 566.

¹¹⁴ Eg, written trusts must be registered with the Master (s 4), the Master must authorise a trustee to act as such (s 6) and the Master may, under certain circumstances, appoint a trustee and co-trustee (s 7).

¹¹⁵ Du Toit *South African Trust Law: Principles and Practice* 81.

¹¹⁶ Du Toit *South African Trust Law: Principles and Practice* 81–83.

¹¹⁷ Trust Property Control Act 57 of 1988 s 9(1).

¹¹⁸ Cameron *et al* *Honoré's South African Law of Trusts* 262.

¹¹⁹ Olivier *et al* *Trustreg en Praktyk* 1–9.

¹²⁰ *Land and Agricultural Bank of South Africa v Parker* 2005 2 SA 77 (SCA) para 19.

¹²¹ *Nel v Metequity Ltd* 2007 3 SA 34 (SCA).

again considered by the court. In that case the trustees of the trust were Metequity Ltd and Investec Business Services Ltd. The only beneficiary of the trust was Metequity Ltd. The trust deed provided that for as long as Investec Business Services Ltd was a trustee, it alone would exercise and carry out the powers and duties of the trustees. The two trustees were wholly owned subsidiaries of Metboard Ltd. They acted as nominees of Metboard Ltd and had no functions other than those in terms of the trust deed and other similar trust deeds. It was contended that the trust was not a valid trust in that there was an identity of interests between the trustees and the beneficiary. The court held:

“[T]he fact that trustees and beneficiaries have identical interests insofar as the object of the trust is concerned is not the identity of interests in the same person, purporting to act in different capacities which, as was stated by Cameron JA in *Land and Agricultural Bank*, is inimical to the trust idea. Identical interests will invariably exist in relation to the fulfilment of the trust objects. The beneficiaries' interest in the trust is that effect be given to the trust deed and it is the obligation of the trustees to do so. As Goldblatt J stated [in the judgement of the court *a quo*], the separate personalities of the corporate trustees, even where one is also a beneficiary, preclude an inimical identity from arising.”¹²²

Beneficiaries under a trust are entitled to certain rights. According to Cameron *et al*, the beneficiary's basic right is that the trust must be properly administered so that he or she can enjoy the benefits to which he or she is entitled or potentially entitled. Beneficiaries may have either vested or contingent rights.¹²³ A beneficiary is said to have a vested right if he or she has an unconditional personal right against the trustees for the delivery of income or capital to which he or she is entitled.¹²⁴ If a beneficiary has a vested right, that does not mean that the beneficiary owns the trust assets.¹²⁵ Indeed, the trustees remain the owners of the assets. Neither does it necessarily mean that the beneficiaries will immediately become entitled to the trust income or capital. The income could be accumulated or capitalised for the future enjoyment of the beneficiaries, whilst already vested in them.¹²⁶ A

¹²² *Nel v Metequity Ltd* 2007 3 SA 34 (SCA) 38. In a second argument it was contended that the trustees' corporate veils should be lifted and that the two trustees should be treated as one, but this argument was dismissed by the court since there was no improper conduct in the establishment or use of the corporate trustees or in the conduct of their affairs.

¹²³ Cameron *et al* *Honoré's South African Law of Trusts* 556.

¹²⁴ The words 'vested right' have more than one meaning. In *Jewish Colonial Trust v Estate Nathan* 1940 AD 163, Watermeyer JA explained the different meanings as follows (at 175): "When it is said that a right is vested in a person, what is usually meant is that such person is the owner of that right – that he has all rights of ownership in such right including the right of enjoyment. ... But the word is also used in another sense, to draw a distinction between what is certain and what is conditional; a vested right as distinguished from a contingent or conditional right." In *Estate Dempers v Secretary for Inland Revenue* 1977 3 SA 410 (A) the court was called upon to decide whether a provision similar to the current s 7(5) of the Income Tax Act applied only in cases where beneficiaries had vested rights. The court referred (at 425) to the latter meaning attached to the term in the *Jewish Colonial Trust* case, ie that a vested right is a certain, unconditional and immediately acquired right, which is contrasted to a contingent right which is conditional and uncertain. See also Van der Merwe (2000) 12 SA Merc LJ 319 319 and Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 317.

¹²⁵ Cameron *et al* *Honoré's South African Law of Trusts* 557; Olivier and Honiball *International Tax: a South African Perspective* 119.

¹²⁶ Olivier and Honiball *International Tax: a South African Perspective* 119; Anonymous (1992) 41 *The Taxpayer* 228 228.

trust in which the beneficiaries have vested rights is known as a vested or vesting trust.¹²⁷ A discretionary trust, on the other hand, is a trust in which the beneficiaries' rights are conditional and uncertain. The condition to which the beneficiaries' rights are subject, is the exercise by the trustees of their discretion.¹²⁸ In such a case, the trustees typically have the discretion to determine not only which beneficiaries (if any) are to receive an amount from the trust, but also the amount of the distribution.¹²⁹

2.2.5 Requirements for the formation of a valid trust

According to Cameron *et al* there are five requirements for the formation of a valid trust:¹³⁰

- (a) The settlor must intend to create a trust. In the case of an *inter vivos* trust, the intention to create a trust must be shared by the settlor and the trustee(s). An *inter vivos* trust is one created during the lifetime of the settlor and is usually created by way of an agreement between the settlor and the trustees.¹³¹ There is no need to comply with any formalities in order to form an *inter vivos* trust (unless formalities are prescribed for the relevant contract by which the trust is formed). An *inter vivos* trust may therefore take the form of an oral agreement. Such an oral trust will not be regarded as a trust for purposes of the Trust Property Control Act¹³² and will be governed by the common law.¹³³ An *inter vivos* trust may be contrasted to a testamentary trust which is created in the will of the testator. The will must comply with all the requirements for a valid will.
- (b) The settlor's intention must be expressed in a mode appropriate to create an obligation.

The relevant obligation is either the obligation on the trustee to administer the trust property for the trust object, or the obligation on the settlor to do what is needed so that the property is administered by the trustee.¹³⁴ In the case where a trustee has not been appointed, has not accepted office, or has been appointed, but has not yet taken control of the trust property, the relevant obligation is the one on the settlor to enable

¹²⁷ Some writers prefer the term "vesting trust" (eg Clegg and Stretch *Income Tax in South Africa* para 5A.7.3.1), while others prefer the term "vested trust" (eg Davis *et al* *Juta's Commentary on Income Tax* Commentary on s 25B). Some writers seem to use the words interchangeably (eg Olivier (2002) *TSAR* 220 222). It is submitted that the two terms are indeed interchangeable.

¹²⁸ There could, of course, be situations in which there is no discretionary trust, but beneficiaries' rights are conditional, ie where some other condition is imposed.

¹²⁹ Cameron *et al* *Honoré's South African Law of Trusts* 348. See also Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 317–319.

¹³⁰ Cameron *et al* *Honoré's South African Law of Trusts* 117; Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 313. See also Coetzee 'n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 135–143.

¹³¹ There are other instruments through which trusts may be formed (Cameron *et al* *Honoré's South African Law of Trusts* 137), but since the contract and the will are the forms most commonly used, the scope of this research will be limited to these forms.

¹³² The Trust Property Control Act defines a trust in s 1, inter alia, as "an arrangement ... by virtue of a trust instrument ...". A "trust instrument" is, in turn, defined as "a written agreement or a testamentary writing or a court order according to which a trust was created". See also *Deedat v The Master* 1995 2 SA 337 (A) 384.

¹³³ Du Toit *South African Trust Law: Principles and Practice* 8.

¹³⁴ Cameron *et al* *Honoré's South African Law of Trusts* 138.

the trustee to administer the trust property. For example, the settlor may be obliged to transfer property to the trustees.¹³⁵

- (c) The trust property must be defined with reasonable certainty.
- (d) The trust object must be defined with reasonable certainty.
- (e) The trust object must be lawful.

In *Administrators, Estate Richards v Nichol*,¹³⁶ the court confirmed that these were the requirements for the formation of a valid trust. According to Du Toit there are two further “elements” which are auxiliary to the five requirements listed above. Although these elements are not requirements for the formation of a valid trust, a failure to comply with these elements may lead to the conclusion that no valid trust was formed or that a trust must fail. These elements are:

- (a) If the settlor makes over trust property to the trust, the settlor must divest himself or herself of control over the trust property in favour of the trustee and the trustee should function free from any control by the settlor.¹³⁷
- (b) There must be a separation between control over the trust property by the trustee and enjoyment of the benefits associated with the trust by the beneficiaries.¹³⁸

For Cameron *et al*, “element” (a) mentioned by Du Toit forms part of requirement (a), namely the intention to create a trust. If the settlor fails to confer the required independence on the trustee, or does not have the intention to vest property in the trustee, the intention to create a trust may be absent.¹³⁹

One of the factors not essential to the formation of a trust is official authority. In other words, even though most trusts are governed by the Trust Property Control Act, trusts are not formed by virtue of this statute.¹⁴⁰ The Trust Property Control Act does require lodgement of the trust instrument with the Master.¹⁴¹ It also provides for authorisation by the Master of the trustees, who are not allowed to act in their capacity as such without this authorisation. Acts performed by trustees before the required authorisation is obtained, will be invalid.¹⁴² The Trust Property Control Act also provides that the Master will not authorise the trustees to act unless they provide security to the Master’s satisfaction.¹⁴³ However, that

¹³⁵ Cameron *et al* *Honoré’s South African Law of Trusts* 138; Du Toit *South African Trust Law: Principles and Practice* 29.

¹³⁶ *Administrators, Estate Richards v Nichol* 1996 4 SA 253 (C).

¹³⁷ Olivier *et al* does not regard the independence of a trustee as an essential element of a trust. Instead it is regarded as an accessory to the office of trustee, indicating how a trustee should act in the administration of the trust (Olivier *et al* *Trustreg en Praktyk* 2–15).

¹³⁸ Du Toit *South African Trust Law: Principles and Practice* 27.

¹³⁹ Cameron *et al* *Honoré’s South African Law of Trusts* 118.

¹⁴⁰ Cameron *et al* *Honoré’s South African Law of Trusts* 176.

¹⁴¹ Trust Property Control Act 57 of 1988 s 4.

¹⁴² *Simplex (Pty) Ltd v Van der Merwe & Others NNO* 1996 1 SA 111 (W); *Van der Merwe v Van der Merwe* 2000 2 SA 519 (C); *Kriel v Terblanche NO* 2002 6 SA 132 (NC); *Lupacchini NO v Minister of Safety and Security* 2010 6 SA 457 (SCA).

¹⁴³ Trust Property Control Act 57 of 1988 s 6.

does not mean that a trust is formed via the lodgement of the trust deed or authorisation by the Master or that the trust does not exist if these acts are not performed.

2.2.6 Administration of a trust

Once it is established that a valid trust has been formed, certain consequences follow. One relates to the administration of the trust. Regarding the internal administration of the trust, the trust instrument usually provides when, where and how meetings of trustees should be held, and the procedures to be followed at these meetings.¹⁴⁴ It has also been suggested that if there is more than one trustee, a chairperson should be appointed.¹⁴⁵ In the absence of provisions dealing with the issue, meetings should be held at the place and on intervals as the chairperson may direct, but a meeting should be held at least once a year, or more if the standard of conduct expected of trustees¹⁴⁶ requires it.¹⁴⁷

Cameron *et al* argue that trustees must act jointly regarding internal administration.¹⁴⁸ What is trite, though, is that in dealings with outsiders all the trustees must act jointly in order to bind the trust (in the absence of contrary provisions in the trust deed).¹⁴⁹ Indeed, in *Land and Agricultural Bank of South Africa v Parker* Cameron JA described the duty to act jointly as "forming the basis of trust law in this country".¹⁵⁰ Outsiders dealing with a trust should therefore assume that all the trustees of a trust must act jointly when contracting on behalf of the trust, unless the trust instrument contains provisions to the contrary.¹⁵¹ Hence and to enable the trust to function effectively, the trust deed often provides for the appointment of an executive or managing trustee who takes care of running the trust's affairs.¹⁵² This trustee can be authorised in terms of an explicit provision in the trust instrument or in terms of express or implied authorisation granted to this trustee by the other trustees in accordance with the trust deed.¹⁵³

Similarly, trustees may delegate some of their functions, such as the everyday administration of the trust, to others, for example, an outside company.¹⁵⁴ Trustees are also allowed to consult experts.¹⁵⁵ Trustees are not permitted to abdicate their responsibilities, though, and such abdication may lead to the invalidity of the act.¹⁵⁶ Trustees therefore are the only ones who can make the decisions regarding the achievement of the trust object and remains

¹⁴⁴ Du Toit (2013) 27 *Trust Law International* 18 21.

¹⁴⁵ Cameron *et al* *Honoré's South African Law of Trusts* 312.

¹⁴⁶ In terms of the Trust Property Control Act 57 of 1988 s 9(1), trustees must act with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another.

¹⁴⁷ Cameron *et al* *Honoré's South African Law of Trusts* 322.

¹⁴⁸ Cameron *et al* *Honoré's South African Law of Trusts* 324.

¹⁴⁹ Cameron *et al* *Honoré's South African Law of Trusts* 342; Du Toit *South African Trust Law: Principles and Practice* 97; Du Toit (2013) 27 *Trust Law International* 18 18.

¹⁵⁰ *Land and Agricultural Bank of South Africa v Parker* 2005 2 SA 77 (SCA) para 15. See also *Pascoal v Wurdeman* 2012 3 SA 422 (GSJ) para 19.

¹⁵¹ Cameron *et al* *Honoré's South African Law of Trusts* 324; Du Toit (2013) 27 *Trust Law International* 18 22.

¹⁵² Du Toit *South African Trust Law: Principles and Practice* 98; *Coetzee v Peet Smith Trust* 2003 5 SA 674 (T); Du Toit (2013) 27 *Trust Law International* 18 23.

¹⁵³ Du Toit *South African Trust Law: Principles and Practice* 98; Du Toit (2013) 27 *Trust Law International* 18 23.

¹⁵⁴ Cameron *et al* *Honoré's South African Law of Trusts* 326; Du Toit (2013) 27 *Trust Law International* 18 22.

¹⁵⁵ Cameron *et al* *Honoré's South African Law of Trusts* 328; Du Toit *South African Trust Law: Principles and Practice* 96.

¹⁵⁶ *Hoosen and Others NNO v Deedat* 1999 4 SA 425 (SCA).

responsible for such achievement, even if they have handed over certain (lesser) duties to others. Fundamental decisions regarding the trust should therefore be taken by the trustees, but implementation may be delegated to others.¹⁵⁷ Trustees, however, retain the duty to supervise the work of any person to whom a task was delegated.¹⁵⁸ In *Hoosen and Others NNO v Deedat*¹⁵⁹ one of the trustees suffered a stroke which left him sound of mind, but incapable of attending meetings of the trustees and performing related duties as trustee. He therefore granted a special power of attorney to his daughter-in-law to represent him at meetings of the trustees, thereby transferring all his rights, duties and powers (including the power to vote at meetings as she pleased) to his daughter-in-law. The court had to decide whether the trustee was entitled in law to delegate his duties *qua* trustee in terms of the power of attorney to his daughter-in-law. The court held that the trust deed did not provide, either expressly or impliedly, that such a delegation could take place. According to the court this accorded with the principle that fundamental decisions relating to the trust had to be taken by the trustees. Hence the delegation to the daughter-in-law was legally impermissible.

Where the trustees are subject to an unacceptable degree of control by the settlor, it may well indicate that the settlor never had the intention to create a trust in the first place, resulting in the invalidity of the trust.¹⁶⁰

2.3 United Kingdom

2.3.1 A brief history

2.3.1.1 General

After the union of the Scottish and English parliaments in 1707, Scotland retained its own laws and legal system, subject to amendment by new legislation from Westminster. All United Kingdom legislation applies to Scotland, unless the contrary is expressly stated.¹⁶¹ The Scottish parliament does have the power to make legislation in all Scottish matters except certain reserved areas which remain the exclusive preserve of the United Kingdom parliament. For example, the power to make legislation regarding fiscal matters is in the hands of the United Kingdom parliament and such legislation will, unless stated specifically, also apply to Scotland.¹⁶²

2.3.1.2 England

The trust originated in England in medieval times and was called the “use”. The use developed against the backdrop of the common law system of landholding, which was based

¹⁵⁷ Cameron *et al* *Honoré’s South African Law of Trusts* 327; Du Toit *South African Trust Law: Principles and Practice* 97.

¹⁵⁸ Cameron *et al* *Honoré’s South African Law of Trusts* 328.

¹⁵⁹ *Hoosen and Others NNO v Deedat* 1999 4 SA 425 (SCA).

¹⁶⁰ Cameron *et al* *Honoré’s South African Law of Trusts* 137.

¹⁶¹ Busby *et al* *Scots Law: A Student Guide* 22.

¹⁶² Busby *et al* *Scots Law: A Student Guide* 25. This is subject, however, to the Scottish Parliament’s limited powers to raise taxes. On 1 May 2012 the Scotland Act 2012 received Royal Assent. In terms of this act, certain powers were devolved on the Scottish Parliament. Most importantly, the power to set income tax rates in Scotland was granted to the Scottish Parliament. However, it is only expected to apply from April 2016.

on the feudal system.¹⁶³ The king was the owner of all land and he could grant an interest or an estate over land to one of his subjects, typically a knight.¹⁶⁴ They could then grant the legal right to possess land to a tenant, who was bound to render “incidents” to the knight, in return for some form of protection from the knight. The chain comprising two-way relationships of tenure could consist of only one link, or many.¹⁶⁵ According to Moffat, the use was employed by tenants as follows:

“A tenant P would convey his land to a group of trustees (say Q, R and S) ‘to the use of’ himself as beneficiary, then to such uses as he should subsequently appoint. By his ‘last will’... or by prior instructions, he would indicate such uses.”¹⁶⁶

The use served a number of purposes: feudal incidents could be avoided; the range of dispositions available to a tenant became much greater than before; secret conveyancing of land became possible; and, for a brief period, it was possible to transfer land to one’s own use in order to defeat the claims of creditors.¹⁶⁷ Another purpose of the use became apparent during the crusades, when a knight would transfer his interest or estate over land to a trusted friend, to hold until he returned.¹⁶⁸ If the friend failed to retransfer the interest or estate over land, the knight had no remedy at common law, because the friend was regarded as the owner.¹⁶⁹ All the knight could do, was petition the King to force the friend, in equity, to return the knight’s interest. The King referred these petitions to the Chancellor, who first advised the King, but later made orders on his own authority. Similarly, Franciscan friars, who were prohibited by an oath of poverty from owning land, saw to it that land was transferred to a knight to hold it for the use of the Order of Franciscan Friars. If the knight kept the benefits to himself, the Order would petition the King for an order against the errant knight.¹⁷⁰ The Chancellor not only recognised the legal estates in land, but also forced

“the legal estate owner to use his legal ownership for the benefit of the beneficiaries, who in equity were supposed to benefit exclusively from the land vested in the legal estate owner. The beneficiaries could thus have equitable estates corresponding to the types of legal estate.”¹⁷¹

¹⁶³ Moffat *et al* *Trusts Law* 36.

¹⁶⁴ Hardy in *Topical Analysis* para 1.2.1 ; Hayton *The Law of Trusts* 10. See also Coetzee ‘n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 40.

¹⁶⁵ Moffat *et al* *Trusts Law* 36; Howard (2005) 2005–2006 *U Miami Int’l & Comp LR* 344 348. See also Coetzee ‘n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 40.

¹⁶⁶ Moffat *et al* *Trusts Law* 37.

¹⁶⁷ Moffat *et al* *Trusts Law* 38; Sonneveldt in *The Trust: Bridge or Abyss between Common and Civil Law Jurisdictions?* 3. See also Coetzee ‘n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 58–60.

¹⁶⁸ Moffat *et al* *Trusts Law* 38; Hayton *The Law of Trusts* 10; De Waal (2000) 117 *SALJ* 548 553; Howard (2005) 2005–2006 *U Miami Int’l & Comp LR* 344 149; Hudson *Equity and Trusts* 45.

¹⁶⁹ Hardy in *Topical Analysis* para 1.2.1.

¹⁷⁰ Hayton *The Law of Trusts* 11; De Waal (2000) 117 *SALJ* 548 553; Howard (2005) 2005–2006 *U Miami Int’l & Comp LR* 344 349; Hudson *Equity and Trusts* 45. See also Coetzee ‘n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 51–56.

¹⁷¹ Hayton *The Law of Trusts* 12.

Thus the interest of the beneficiary was recognised as a proprietary interest which could be enforced against anyone except a third party without notice, who acquired the property for value.¹⁷²

In 1535 the Statute of Uses was enacted. In terms of this statute, the beneficiary of the trust (the *cestui que use*), and not the trustee (the *feoffee to use*), would obtain legal title, thus converting the beneficiary's equitable rights into legal title.¹⁷³ The main purpose of the Statute of Uses was to increase feudal incidents for the King.¹⁷⁴ One of the exceptions to the Statute of Uses was a use upon a use (for example land was conveyed to A to hold to the use of B to the use of C), where the Chancery Division was eventually prepared to enforce the second use (B to the use of C) in equity.¹⁷⁵ The enforced use became known as the trust, to distinguish it from the first use.¹⁷⁶ The characteristic of the use, namely divided ownership, became a feature of the trust.¹⁷⁷

2.3.1.3 Scotland

The development of the trust institution in Scotland was not significantly influenced by English law. Although more substantial influence from England followed after 1840, the Scottish trust had already been firmly established by that time.¹⁷⁸ Importantly, the division of legal and equitable ownership found in English law was never received in Scotland.¹⁷⁹

The exact origin of the Scottish trust seems uncertain.¹⁸⁰ According to Forsyth, who wrote the first book on trusts in Scotland in 1944, the Scottish trust derives from the Roman law *fideicommissum*.¹⁸¹ The term "trust" was only used by the seventeenth century in Scotland, but this is neither here nor there as the institution may have existed earlier on without the name "trust".¹⁸² Stair discusses the trust in his *Institutions of the Law of Scotland*,¹⁸³ which was first published in 1681. He characterises a trust as a combination of mandate and deposit, which strengthens the point that the trust existed prior to the seventeenth century and that it was not simply an institution taken over from England in that period.¹⁸⁴ Examples of the use of trust-like institutions can also be found prior to the seventeenth century.¹⁸⁵

¹⁷² De Waal (2000) 117 SALJ 548 553; De Waal (2001) 12 Stell LR 63 64; Sonneveldt in *The Trust: Bridge or Abyss between Common and Civil Law Jurisdictions?* 4.

¹⁷³ The Statute of Wills, which was enacted due to the negative reaction by the aristocracy to the Statute of Uses, enabled land to be devised by will at common law. (Hayton *The Law of Trusts* 12; Moffat *et al Trusts Law* 42).

¹⁷⁴ Moffat *et al Trusts Law* 41; Hayton *The Law of Trusts* 12.

¹⁷⁵ Moffat *et al Trusts Law* 44; Hayton *The Law of Trusts* 12; Hardy in *Topical Analysis* para 1.2.1.

¹⁷⁶ Hayton *The Law of Trusts* 12. See also Coetzee 'n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 60-61.

¹⁷⁷ De Waal (2001) 12 Stell LR 63 64.

¹⁷⁸ Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 511.

¹⁷⁹ Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 532.

¹⁸⁰ Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 511. For a discussion of the sources of trust law in Scotland, see Coetzee 'n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 155-171.

¹⁸¹ Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 512.

¹⁸² Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 513.

¹⁸³ Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 513.

¹⁸⁴ Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 516.

¹⁸⁵ Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 514.

Stair also compares the trust to the *fideicommissum*, and the conclusion reached by Gretton is that the *fideicommissum* was one of the sources of the trust, but the extent of its role is hard to determine.¹⁸⁶

Legislation such as The Trusts (Scotland) Act 1921, the Trusts (Scotland) Act 1961 and the Charities and Trustee Investment (Scotland) Act 2005 also played a role in the development of trust law in Scotland.¹⁸⁷

2.3.2 Definitions

2.3.2.1 England

Underhill and Hayton define a trust as follows:

“A trust is an equitable obligation, binding a person (called a trustee) to deal with property (called trust property) owned by him as a separate fund, distinct from his own private property, for the benefit of persons (called beneficiaries or, in old cases *cestuis que trust*), of whom he may himself be one, and any one of whom may enforce the obligation. ... Any act or neglect on the part of a trustee which is not authorized or executed by the terms of the trust instrument, or by law, is called a breach of trust.”¹⁸⁸

Mowbray *et al* provide the following description:

“[The word trust] refers to the duty of aggregate accumulation of obligations that rest upon a person described as trustee. The responsibilities are in relation to property held by him, or under his control. That property he will be compelled by a court in its equitable jurisdiction to administer in the manner lawfully prescribed by the trust instrument, or where there be no specific provision, written or oral, or to the extent that such provision is invalid or lacking, in accordance with equitable principles. As a consequence the administration will be in such a manner that the consequential benefits and advantages accrue, not to the trustee, but to the persons called *cestuis que trust*, or beneficiaries, if there be any; if not, for some purpose which the law will recognise and enforce. A trustee may be a beneficiary, in which case advantages will accrue in his favour to the extent of his beneficial interest.”¹⁸⁹

According to Hayton

“[t]here is no statutory definition of the trust which can be used as a major premise from which rules relating to the trust can be deduced.”¹⁹⁰

The courts have, therefore, expounded the rules of trust law and a description of these rules will convey a general idea of what a trust is.¹⁹¹ It must, however, be borne in mind that the United Kingdom is a signatory to the Convention on the Law Applicable to Trusts and on

¹⁸⁶ Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 518.

¹⁸⁷ Gretton *et al* *Property, Trusts and Succession* 318.

¹⁸⁸ Hutton *Tolley's UK Taxation of Trusts* 9, quoting Underhill and Hayton, *Law of Trusts and Trustees* 17ed 2.

¹⁸⁹ Mowbray *et al* *Lewin on Trusts* 4.

¹⁹⁰ Hayton *The Law of Trusts* 6.

¹⁹¹ Hayton *The Law of Trusts* 6.

their Recognition (“The Hague Convention on Trusts”). The definition of “trust” in The Hague Convention on Trusts therefore forms part of statutory law in the United Kingdom.¹⁹² This definition reads as follows:

“For the purposes of this Convention, the term “trust” refers to the legal relationships created – *inter vivos* or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.

A trust has the following characteristics –

- a) the assets constitute a separate fund and are not part of the trustee’s own estate;
- b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;
- c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.

The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.”¹⁹³

The Income Tax Act 2007 defines the term “settled property” as follows:

“‘Settled property’ means any property held in trust other than property excluded by subsection (3).”¹⁹⁴

Subsection 3 excludes property if:

- (a) it is held by a person as nominee for another person;
- (b) it is held by a person as trustee for another person who is absolutely entitled to the property as against the trustee; or
- (c) it is held by a person as trustee for another person who would be absolutely entitled to the property as against the trustee if that other person were not an infant or otherwise lacking legal capacity.

A person is absolutely entitled to property as against a trustee if the person has the exclusive right to direct how the property is to be dealt with (subject to the trustees' right to use the property for the payment of duty, taxes, costs or other outgoings). References to a person

¹⁹² The Recognition of Trusts Act (1987). Although the Hague Convention on Trusts is discussed under the section dealing with the law in the United Kingdom, it has a wider application and is used in many other countries, including some of the other countries discussed in this research.

¹⁹³ Convention on the Law Applicable to Trusts and on their Recognition art 2.

¹⁹⁴ Income Tax Act 2007 s 466.

who is or would be so entitled, include references to two or more persons who are or would be jointly absolutely entitled as against the trustee.¹⁹⁵

Furthermore, the Income Tax Act provides that the trustees of a settlement are together treated as if they were a single person (distinct from the persons who are the trustees of the settlement from time to time).¹⁹⁶

2.3.2.2 Scotland

A trust has been defined as “an interest created by the transfer of property to a trustee, in order that he may carry out the settlor’s direction respecting its management and disposal”.¹⁹⁷

Another definition which has been offered by academic writers is the following:

“A trust then is a legal relationship in which property is vested in one person, the trustee, who is under a fiduciary obligation to apply the property to some extent for the benefit of another person, the beneficiary, the obligation being a qualification of the trustee’s proprietary right and preferable to all claims of the trustee or his creditors.”¹⁹⁸

It should also be borne in mind that The Recognition of Trusts Act (1987) also applies to Scotland, which means that the definition of “trust” in The Hague Convention on Trusts equally applies in Scotland.

The Income Tax Act 2007¹⁹⁹ provides as follows:

- “(1) This section applies if –
 - (a) income arises to trustees under a trust having effect under the law of Scotland,
 - (b) the trustees are UK resident, and
 - (c) a beneficiary under the trust (“B”) would have an equitable right in possession to the income if the trust had effect under the law of England and Wales.
- (2) B is treated for income tax purposes as having an equitable right in possession to the income (even though B has no such right under the law of Scotland).”

2.3.3 Legal nature and key features

2.3.3.1 England

In English law a trust is not a juristic person and is therefore not capable of owning property. The trust property is owned by the trustee,²⁰⁰ or if more than one trustee, by them as joint

¹⁹⁵ Income Tax Act 2007 ss 466(5) and (6).

¹⁹⁶ Income Tax Act 2007 s 474.

¹⁹⁷ De Waal (2000) 117 SALJ 548 549, quoting Norrie, Scobbie and Dalgleish *Trusts* (1991) 1.

¹⁹⁸ Wilson and Duncan *Trusts, Trustees and Executors* 20.

¹⁹⁹ Income Tax Act 2007 s 464.

²⁰⁰ Moffat *et al Trusts Law* 4; Riddall *The Law of Trusts* 1; Hudson *Equity and Trusts* 52.

tenants.²⁰¹ The trust property, however, comprises a separate fund, which is available only to the beneficiaries and not to the trustee's personal creditors or heirs.²⁰² Trustees also have a duty to separate trust assets from their personal assets.²⁰³

Trustees have fiduciary obligations to the beneficiaries, which entail that they cannot use their position for their own benefit. Instead the trust property must be used for the benefit of the beneficiaries.²⁰⁴ A trustee's fiduciary duties further entail that he or she must act in good faith. Trustees must avoid conflicts between their own self-interest and their fiduciary duty²⁰⁵ and they must not profit out of this trust. It goes without saying that trustees must at all times adhere to the provisions of the trust.²⁰⁶

The settlor forms the trust,²⁰⁷ but after its formation usually falls out of the picture, although he or she may reserve certain powers for himself or herself.²⁰⁸ It is therefore the trustees who stand in a relationship with the beneficiaries and only the latter who may enforce their rights against the former.²⁰⁹ The settlor may be a trustee or even a sole trustee, and a beneficiary, but a valid trust will not exist if the settlor is the sole trustee and sole beneficiary, as a person cannot have rights against himself or herself.²¹⁰

As in other jurisdictions, trusts may be formed during the lifetime of the settlor (an *inter vivos* trust) or on his or her death (a testamentary trust).²¹¹ Where a beneficiary has a fixed entitlement to certain income or capital from the trustees, the trust will be a fixed trust.²¹² The fixed trust must be contrasted to a discretionary trust, in which beneficiaries only obtain rights to income or capital when the trustees exercise their discretion in favour of a specific beneficiary.²¹³ In addition, distributive powers of appointment of income or capital are usually found in a trust deed.²¹⁴ One of the differences between a discretionary trust and a power of appointment is that the trustees are obliged to exercise their discretion, whereas the donee of the power is not obliged to exercise such power.²¹⁵ Subject to restrictions on accumulation, trustees may also be given the power (or a trust) to accumulate income, which then becomes part of the trust capital, unless the trustee exercises the power to distribute the income to the beneficiaries instead.²¹⁶

²⁰¹ Hayton *The Law of Trusts* 3.

²⁰² Hayton *The Law of Trusts* 4; Hudson *Equity and Trusts* 57.

²⁰³ Hayton *The Law of Trusts* 141.

²⁰⁴ Hayton *The Law of Trusts* 4; Hudson *Equity and Trusts* 52.

²⁰⁵ Hayton *The Law of Trusts* 139.

²⁰⁶ Moffat *et al Trusts Law* 421. The duties of trustees are discussed comprehensively in Hudson *Equity and Trusts* 353–409.

²⁰⁷ Riddall *The Law of Trusts* 2.

²⁰⁸ Moffat *et al Trusts Law* 14; Hudson *Equity and Trusts* 52.

²⁰⁹ Hayton *The Law of Trusts* 78.

²¹⁰ Hayton *The Law of Trusts* 136; Moffat *et al Trusts Law* 4; Mowbray *et al Lewin on Trusts* 9.

²¹¹ Hayton *The Law of Trusts* 17.

²¹² Hudson *Equity and Trusts* 54.

²¹³ Hayton *The Law of Trusts* 16; Riddall *The Law of Trusts* 2; Mowbray *et al Lewin on Trusts* 22.

²¹⁴ Hayton *The Law of Trusts* 43.

²¹⁵ Riddall *The Law of Trusts* 11; Mowbray *et al Lewin on Trusts* 22; Hudson *Equity and Trusts* 55.

²¹⁶ Hayton *The Law of Trusts* 44.

Although there are certain similarities between a trust and an agency, there are also marked differences.²¹⁷ For example, a person cannot be an agent for a non-existent principal, while trusts for the benefit of persons not yet born are valid. Furthermore, at common law, a principal only has a personal claim against the agent in case of the agent's insolvency,²¹⁸ whereas, in the case of a trustee, a separate trust fund is created to which a trustee's creditors cannot lay claim.²¹⁹ A trustee is therefore not an agent of either the settlor or the beneficiaries, but acts as principal.²²⁰ A trust is also something different from a contract.²²¹

It is possible for a settlor to declare himself or herself trustee of his or her own property.²²²

Although it is clear that the trustee is the owner of the trust assets, the nature of a beneficiary's interest has evolved over time. Initially a beneficiary's interest entailed the right to require the trustee to perform under the trust or to make good any losses (that is, a personal right), but later developments broadened the scope of the beneficiary's interest so that it became enforceable against third parties (excluding *bona fide* purchasers for value without notice). Thus the beneficiary's interest acquired a "proprietary hue".²²³ In the case of a fixed trust the beneficiary's interest is easily given a proprietary character, the beneficiary being the equitable owner and the trustee the legal owner.²²⁴ In the case of a discretionary trust, describing a beneficiary's interest as proprietary becomes more problematic, since the beneficiary has no right to demand anything from the trustees and in case of insolvency, nothing passes to the trustee.²²⁵ In *Gartside v IRC*²²⁶ the court held that

"No doubt in a certain sense a beneficiary under a discretionary trust has an 'interest': the nature of it may, sufficiently for the purpose, be spelt out by saying that he has a right to be considered as a potential recipient of benefit by the trustees and a right to have his interest protected by a court of equity ... But that does not mean that he has an interest which is capable of being taxed by reference to its extent in the trust fund's income ..."

The court therefore rejected the notion that beneficiaries of a discretionary trust, as a class, possess the whole of the equitable interest in the trust fund.²²⁷ As mentioned in *Gartside*, the beneficiary under a discretionary trust does have some sort of interest, in the sense that it may be assigned, he or she has the right to be considered as a potential recipient of a benefit and, under the rule in *Saunders v Vautier*,²²⁸ he or she has a right, with other beneficiaries, to bring the trust to an end. Furthermore beneficiaries may prevent the

²¹⁷ Hudson *Equity and Trusts* 72.

²¹⁸ Hayton *The Law of Trusts* 77.

²¹⁹ Hayton *The Law of Trusts* 78.

²²⁰ Mowbray *et al Lewin on Trusts* 13.

²²¹ Hayton *The Law of Trusts* 78; Hudson *Equity and Trusts* 71.

²²² Hayton *The Law of Trusts* 82; Moffat *et al Trusts Law* 116; Mowbray *et al Lewin on Trusts* 39.

²²³ Moffat *et al Trusts Law* 248.

²²⁴ Moffat *et al Trusts Law* 250.

²²⁵ Riddall *The Law of Trusts* 285.

²²⁶ *Gartside v IRC* [1968] 1 All ER 121.

²²⁷ Moffat *et al Trusts Law* 250.

²²⁸ *Saunders v Vautier* (1841) 4 Beav 115. In terms of this rule, all the beneficiaries may, if they are of full age and sound of mind, and together entitled to the whole of the interest, bring the trust to an end by requiring the trustees to transfer the property to them. See also Hudson *Equity and Trusts* 59 and 182–186.

misallocation or mismanagement of the trust.²²⁹ According to some authors, it is therefore uncertain precisely where the equitable interest lies with regard to discretionary trusts.²³⁰ Mowbray *et al* explain the position as follows: A beneficiary has a proprietary right or interest in the broader sense of the term, since he may enforce the trust against anyone (except a *bona fide* purchaser for value without notice). Some beneficiaries are equitable owners of trust assets, namely if the assets are sufficiently ascertained and the beneficiary is the only one interested. Others have equitable proprietary interests in the trust, such as two or more capital beneficiaries concurrently interested. A discretionary beneficiary has no equitable interest in the narrow sense and no equitable ownership, but since he or she may enforce his or her right to be considered by the trustees against the trustees and third parties, he or she has a proprietary interest in the wider sense.²³¹

2.3.3.2 Scotland

As in South Africa, Scottish private law is “mixed”,²³² but its property law is based on a civilian framework.²³³ The divide between legal ownership and equitable ownership is, therefore, unknown in Scottish law. The trustee is the owner of the trust property,²³⁴ but must use the trust property not for his or her own benefit, but for the benefit of the beneficiaries.²³⁵ A trustee is therefore a “fiduciary”, that is, someone who must act in the interest of another. However, what distinguishes a trustee from other fiduciaries, such as agents, is that the trustee is the owner of the trust assets.²³⁶ In a trust, the trustee has two patrimonies (estates),²³⁷ one being the trustee’s personal patrimony and the other being the special patrimony of the trust.²³⁸ The trustee has a duty to keep the two patrimonies segregated, so that it is at all times certain to which of his or her two patrimonies an asset belongs.²³⁹ The trustee’s personal creditors cannot claim against the trustee’s special patrimony. Likewise, the trust creditors cannot touch the trustee’s personal patrimony.²⁴⁰ According to Gretton, this feature of the Scottish trust means that the trust is a distinctive

²²⁹ Moffat *et al Trusts Law* 252.

²³⁰ Moffat *et al Trusts Law* 252. See also the discussion in Hudson *Equity and Trusts* 187–190.

²³¹ Mowbray *et al Lewin on Trusts* 8. See also the discussion in Coetzee ‘*n Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg*’ 225–235.

²³² By a “mixed” legal system is meant a system which draws on both common law and civil law traditions, but where the property law is always based on civilian principles, with other areas of the law influenced to a greater or lesser extent by each of the two traditions (Reid in *Trusts in Mixed Legal Systems* 19).

²³³ Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 510; Reid in *Trusts in Mixed Legal Systems* 19.

²³⁴ In the case of more than one trustee, the trustees are joint owners (Wilson and Duncan *Trusts, Trustees and Executors* 21).

²³⁵ Gretton *et al Property, Trusts and Succession* 319; Wilson and Duncan *Trusts, Trustees and Executors* 15; Gloag and Henderson *The Law of Scotland* 950; Reid in *Principles of European Trust Law* 72.

²³⁶ Gretton *et al Property, Trusts and Succession* 319; Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 509.

²³⁷ Gretton prefers the term “patrimony” over “estate” as the latter term could be used in other senses. (Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 511). He defines a patrimony as “the totality of a person’s assets and liabilities” (Gretton *et al Property, Trusts and Succession* 333) and in this sense the term corresponds with the South African concept of “estate”.

²³⁸ Reid in *Trusts in Mixed Legal Systems* 23.

²³⁹ Gretton *et al Property, Trusts and Succession* 334.

²⁴⁰ Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 511; Wilson and Duncan *Trusts, Trustees and Executors* 145; Gloag and Henderson *The Law of Scotland* 950; Reid in *Trusts in Mixed Legal Systems* 23; Reid in *Principles of European Trust Law* 68.

institution and not an arrangement that can simply be achieved by way of a contract.²⁴¹ In Scottish law, the trust is a separate institution, but not a juristic person.²⁴² According to Reid, trusts “behave” like juristic persons in many respects, because they have an existence independent of a person. A trustee incurs obligations, not in his or her personal capacity, but in the capacity of trustee. If the trustee ceases to be a trustee, he does not hold the relevant obligation anymore. Trustees are also subject to regulation by the courts.²⁴³

The beneficiary is not the owner of the trust property.²⁴⁴ He or she has a personal right against the trustee.²⁴⁵ This right is often referred to as the “beneficial interest”²⁴⁶ and forms part of the beneficiary’s patrimony.²⁴⁷ Although the beneficiary’s right has often been described as a *jus crediti*, this does not paint the full picture, as a beneficiary’s right is more than a mere contractual right. A beneficiary can vindicate trust property on the sequestration of the trustee and can secure the recovery of property from third parties under certain circumstances.²⁴⁸ According to Wilson and Duncan the decision in *Inland Revenue v Clark’s Trs*²⁴⁹ determined that a beneficiary’s interest consists of the following four rights of action:

“(i) a right by personal action, usually of declarator or accounting, to compel the trustees to administer the trust according to its term; (ii) a right to interdict the trustees from breach of trust; (iii) a right to recover damages from the trustees for breach of trust; (vi) a right to petition the court to change the administration of the trust by replacing the trustees by new trustees or a judicial factor.”²⁵⁰

Regarding beneficiaries’ rights, a distinction must be drawn between discretionary and other trusts. In a discretionary trust, for purposes of trust law, the trustees are given a degree of discretion regarding the extent to which certain beneficiaries will benefit.²⁵¹ Thus the beneficiary’s rights will depend on the trustees’ decisions.²⁵² The term “vested”, in the sense of a beneficial right having vested, can have more than one meaning²⁵³ and a great deal of uncertainty surrounds the term.²⁵⁴ It seems, however, that a vested right is a right like any other patrimonial right. Such a right does not necessarily mean that the holder of the right is also the owner of the underlying asset. A right seems to be unvested if it is subject to a

²⁴¹ Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 511; Wilson and Duncan *Trusts, Trustees and Executors* 14.

²⁴² Gretton in *Itinera Fiducia: Trust and Treuhand in Historical Perspective* 511; Wilson and Duncan *Trusts, Trustees and Executors* 21.

²⁴³ Reid in *Trusts in Mixed Legal Systems* 25; Reid in *Principles of European Trust Law* 74.

²⁴⁴ Reid in *Trusts in Mixed Legal Systems* 22; Gloag and Henderson *The Law of Scotland* 950.

²⁴⁵ Wilson and Duncan *Trusts, Trustees and Executors* 15, 18; Reid in *Trusts in Mixed Legal Systems* 22; Reid in *Principles of European Trust Law* 70.

²⁴⁶ *Sharp v Thomson* 1995 SLT 837.

²⁴⁷ Gretton *et al Property, Trusts and Succession* 335.

²⁴⁸ Wilson and Duncan *Trusts, Trustees and Executors* 144; Reid in *Principles of European Trust Law* 70. See also Coetzee ‘n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 239-249.

²⁴⁹ *Inland Revenue v Clark’s Trustees* 1939 SC 11 26.

²⁵⁰ Wilson and Duncan *Trusts, Trustees and Executors* 144.

²⁵¹ Gretton *et al Property, Trusts and Succession* 327; Wilson and Duncan *Trusts, Trustees and Executors* 27.

²⁵² Gretton *et al Property, Trusts and Succession* 335.

²⁵³ Gretton *et al Property, Trusts and Succession* 338.

²⁵⁴ Gretton *et al Property, Trusts and Succession* 337.

condition and the condition was not satisfied.²⁵⁵ Writing on a *mortis causa* settlement, Lord Colonsay held that in order to determine whether a right is vested or not, the intentions of the testator are decisive.²⁵⁶ Case law has developed default rules to ascertain the testator's intention.²⁵⁷ If the beneficiary's right is vested, it is passed on by testate or intestate succession.²⁵⁸

A beneficiary's interest may be assigned to a third party, even if it is a mere non-vested right. In order to complete the assignee's rights, the trustees must be given notice of the assignation.²⁵⁹

Trustees have certain duties. One of them is the duty which limits the power to accumulate income.²⁶⁰ These rules, contained in statute,²⁶¹ are complex and only the basic rule will be stated, namely that the trustees may accumulate income only for the first 21 years of the trust's existence. Once this period has lapsed, income has to be distributed to the beneficiaries.²⁶²

The trustees have further duties, known as fiduciary duties. This entails that the trustees must adhere to the provisions of the trust deed and to the law. Trustees must not authorise transactions in their own interests, unless the trust deed authorises them to do so or the duty is waived by the beneficiaries.²⁶³ Thus, trustees may not buy from, sell to, borrow from, or lend to the trust, as these transactions will cause their interests to conflict with their duties as trustees.²⁶⁴ In executing their duties, trustees must only consider the beneficiaries' interests.²⁶⁵

In order for a trust to take effect, the trust property must be vested in the trustees. Delivery of the trust property is therefore necessary in order to create a trust.²⁶⁶ Case law has dealt with this subject extensively, but the rules that can be distilled, are complex and will not be discussed in detail in this research.²⁶⁷

A valid trust will come into existence where the settlor is the sole trustee.²⁶⁸ Such a trust is known as a "truster/trustee" or a "truster-as-trustee" trust. Gretton and Steven point out that no transfer is possible in such a trust, since a transfer involves two people.²⁶⁹ Wilson and Duncan, on the other hand, cite authority and case law that require that there be a

²⁵⁵ Gretton *et al* *Property, Trusts and Succession* 337.

²⁵⁶ *Carleton v Thomson* 1867 5 M (HL) 151.

²⁵⁷ Gretton *et al* *Property, Trusts and Succession* 338.

²⁵⁸ Wilson and Duncan *Trusts, Trustees and Executors* 148; Gloag and Henderson *The Law of Scotland* 951.

²⁵⁹ Wilson and Duncan *Trusts, Trustees and Executors* 153; Gloag and Henderson *The Law of Scotland* 951.

²⁶⁰ Gretton *et al* *Property, Trusts and Succession* 349.

²⁶¹ Trusts (Scotland) Act 1961 s 5; Law Reform (Miscellaneous Provisions) (Scotland) Act 1968 s 6.

²⁶² Gretton *et al* *Property, Trusts and Succession* 350.

²⁶³ Gloag and Henderson *The Law of Scotland* 957.

²⁶⁴ Gretton *et al* *Property, Trusts and Succession* 351.

²⁶⁵ Gretton *et al* *Property, Trusts and Succession* 352.

²⁶⁶ Wilson and Duncan *Trusts, Trustees and Executors* 41, which also mention an exception to this rule.

²⁶⁷ For a discussion of the cases and rules, see Wilson and Duncan *Trusts, Trustees and Executors* ch 3.

²⁶⁸ Gretton *et al* *Property, Trusts and Succession* 330; Gloag and Henderson *The Law of Scotland* 952; Reid in *Trusts in Mixed Legal Systems* 26.

²⁶⁹ Gretton *et al* *Property, Trusts and Succession* 330; Reid in *Principles of European Trust Law* 76.

physical act equivalent to a transfer.²⁷⁰ Gretton and Steven concede that the rules relating to this type of trust are uncertain, but one requirement seems to be that the declaration of trust must be intimated to at least one beneficiary.²⁷¹ However, if the settlor is the sole trustee and sole beneficiary, the trust will be extinguished.²⁷² Usually a beneficiary may be appointed as a trustee, but in the case of an alimentary liferent there is authority to the effect that at least one trustee should be independent.

2.3.4 Requirements for the formation of a valid trust

2.3.4.1 England

Most trusts created in England are created by the settlor expressly transferring property to the trustees to hold on declared trust.²⁷³ However, English law also recognises resulting trusts and constructive trusts. A resulting trust arises to give effect to presumed intention in certain circumstances.²⁷⁴ For example, a resulting trust may arise where an express trust fails and the beneficial interest in the trust assets then results to the trust settlor. A resulting trust may also arise where property is transferred to a person, but equity presumes that person to hold the property on trust for the transferor.²⁷⁵ A constructive trust, on the other hand, is a trust imposed by law, irrespective of the intention of the parties.²⁷⁶ The classification of trusts into these categories and the law regarding these types of trusts are uncertain and still in the process of development.²⁷⁷ Trusts may also be created by statute, for example in the case of bankruptcy and co-ownership of land.²⁷⁸ However, these types of trusts will not be discussed in this research and references to English law trusts will be confined to so-called “express” trusts.

Until the property has been subjected to the terms of the trust, there can be no trust.²⁷⁹ This means that property must be transferred by the settlor to the trustees and the formalities required for such transfer must be observed.²⁸⁰ For example, a trustee only becomes the owner of full legal title in registered land or shares in a private company on registration.²⁸¹ Upon transfer of the property to the trustee the trust is completed or constituted, thereby transforming the beneficiary’s previously unenforceable hope into a property right.²⁸² What is required of the settlor to constitute a trust is that the trustee must have done everything under his or her control necessary to constitute complete title with no further assistance

²⁷⁰ Wilson and Duncan *Trusts, Trustees and Executors* 289, footnote 75; They are supported by Gloag and Henderson *The Law of Scotland* 952.

²⁷¹ Gretton *et al Property, Trusts and Succession* 330; Gloag and Henderson *The Law of Scotland* 952.

²⁷² Reid in *Principles of European Trust Law* 75.

²⁷³ Hayton *The Law of Trusts* 16. The other requirements are discussed below.

²⁷⁴ Hayton *The Law of Trusts* 17.

²⁷⁵ Hudson *Equity and Trusts* 49–50.

²⁷⁶ Moffat *et al Trusts Law* 24; Hudson *Equity and Trusts* 50.

²⁷⁷ Moffat *et al Trusts Law* 28.

²⁷⁸ Hayton *The Law of Trusts* 44–47.

²⁷⁹ Hayton *The Law of Trusts* 129; Moffat *et al Trusts Law* 122; Riddall *The Law of Trusts* 48.

²⁸⁰ Riddall *The Law of Trusts* 51. If, however, the property transferred is an equitable interest, the transfer must be in writing and signed by the settlor (Law of Property Act 1925 s 53(1)(c)). See also Hudson *Equity and Trusts* 245–250.

²⁸¹ Hayton *The Law of Trusts* 130.

²⁸² Moffat *et al Trusts Law* 119; Riddall *The Law of Trusts* 91; Hudson *Equity and Trusts* 245.

required by the settlor or equity.²⁸³ If a settlor declares himself or herself trustee of his or her property, no formalities are required, since there is no transfer. Thus a declaration of trust will suffice to constitute a trust.²⁸⁴ If, however, the property involved is land (and whether or not the property is to be transferred to trustees), the trust must be evidenced in writing and signed by the settlor in order for it to be enforced.²⁸⁵ It should also be noted that only the settlor (or his or her authorised agent) can constitute a trust of the settlor's property.²⁸⁶

In general, though, no formalities are required for the declaration of an *inter vivos* trust. Indeed, trusts need not be created by writing,²⁸⁷ although most trust deeds are in writing. Neither do trustees have to be appointed on creation, although they usually are.²⁸⁸ However, the formalities for the transfer of trust property must be complied with and trusts of land must be reduced to writing.²⁸⁹ Further formalities must be met if an equitable interest is made the subject of a trust.²⁹⁰ If a trust is created by way of a will (a testamentary trust) the formalities for a valid will must be adhered to.²⁹¹ A testamentary trust will be completely constituted once the will is admitted to probate.²⁹²

In order to create a valid trust, certain requirements must be met. These are:

- (a) There must be certainty of the intention to create a trust.²⁹³ The intention of the settlor will be looked at to determine whether a trust has been created.²⁹⁴ Thus, even if the intention to create a trust is expressed clearly, but the real intention is not to create a trust, no trust will be formed. Equally, if informal language is used indicating the settlor's wish for trust-like consequences, a trust will be formed.²⁹⁵ A general intention to benefit another is not adequate, though. What is required, is a specific intention to benefit by way of a trust.²⁹⁶

²⁸³ Mowbray *et al Lewin on Trusts* 59.

²⁸⁴ Riddall *The Law of Trusts* 48.

²⁸⁵ Law of Property Act 1925 s 53(1)(b).

²⁸⁶ Hayton *The Law of Trusts* 134.

²⁸⁷ Riddall *The Law of Trusts* 51; Hudson *Equity and Trusts* 52 and 244.

²⁸⁸ Moffat *et al Trusts Law* 116.

²⁸⁹ Hayton *The Law of Trusts* 16; Moffat *et al Trusts Law* 122; Law of Property Act 1925 s 53(1); Hudson *Equity and Trusts* 243.

²⁹⁰ Moffat *et al Trusts Law* 126.

²⁹¹ Wills Act 1837 s 9. See also Hudson *Equity and Trusts* 243. Secret trusts are, however valid. In a secret trust the testator leaves property to a trusted friend, but while the testator was alive, he/she informed the friend that the property is to be held on trust. Provided that the friend accepts the trust, it will be enforceable. Similarly, half-secret trusts are enforceable. A half-secret trust is mentioned in the will, but the details of beneficial entitlement are not mentioned. For a comprehensive description of secret and half-secret trusts, see Hudson *Equity and Trusts* 300–326.

²⁹² Mowbray *et al Lewin on Trusts* 74. To get probate of a will means that the will is approved by the Family Division of the High Court (Riddall *The Law of Trusts* 315).

²⁹³ See Hudson *Equity and Trusts* 92–116 for a detailed discussion of this requirement.

²⁹⁴ Moffat *et al Trusts Law* 31.

²⁹⁵ Hayton *The Law of Trusts* 75; Moffat *et al Trusts Law* 160; Riddall *The Law of Trusts* 32; Mowbray *et al Lewin on Trusts* 84.

²⁹⁶ Moffat *et al Trusts Law* 160; Hudson *Equity and Trusts* 92–93.

- (b) There must be certainty of the subject matter of the trust.²⁹⁷ The particular property which is to be held in trust must therefore be identified,²⁹⁸ as well as the *quantum* of each beneficiary's interest in the trust.²⁹⁹ The latter rule is subject to certain remedies, including that a discretion may be conferred on the trustees to decide which beneficiaries will receive and how much they will receive.³⁰⁰
- (c) There must be certainty of the objects of the trust.³⁰¹ The beneficiaries must be certain.³⁰² In the absence of certainty regarding the beneficiaries of the trust, a resulting trust will be created in favour of the settlor or his or her estate.³⁰³
- (d) The trust must be administratively workable,³⁰⁴ in other words, the terms of the trust instrument (or admissible extrinsic evidence) has to provide clear criteria which would enable a court to act judicially upon them.³⁰⁵
- (e) The beneficiary principle must be adhered to.³⁰⁶ This principle entails that there must be beneficiaries with *locus standi* to enforce the trust (exceptions being made for certain anomalous cases).³⁰⁷ Thus, according to Hayton "[i]t follows that a trust may be created for the benefit of persons but not for a purpose unless that purpose be charitable, for a purpose cannot sue, but if it be charitable the Attorney General may sue to enforce it."³⁰⁸

Furthermore, trusts will be void if they are formed for an illegal purpose or contrary to public policy.³⁰⁹ English law also has certain rules against perpetuity or accumulations. In terms of the rule against purpose trusts of excessive duration, a trust will be invalid if the trust property is to be applied indefinitely for a non-charitable purpose. In terms of common law, the trust would be valid if a person would become absolutely entitled to the trust property at the end of the perpetuity period of 21 years or within 21 years from the death of a person living when the trust is created.³¹⁰ The rule against remoteness of vesting, found in the common law, was amended by legislation.³¹¹ This rule is, however, complex and a discussion of its detail falls outside the scope of this research. In terms of the rule against

²⁹⁷ For a detailed discussion of this requirement, see Hudson *Equity and Trusts* 116–146.

²⁹⁸ Hayton *The Law of Trusts* 84; Moffat *et al Trusts Law* 173; Riddall *The Law of Trusts* 32; Hudson *Equity and Trusts* 116.

²⁹⁹ Moffat *et al Trusts Law* 121; Riddall *The Law of Trusts* 44.

³⁰⁰ Moffat *et al Trusts Law* 179.

³⁰¹ For a detailed discussion of this requirement, see Hudson *Equity and Trusts* 146–178.

³⁰² Moffat *et al Trusts Law* 121; Riddall *The Law of Trusts* 34; Mowbray *et al Lewin on Trusts* 99; Hudson *Equity and Trusts* 146.

³⁰³ Hayton *The Law of Trusts* 87.

³⁰⁴ Mowbray *et al Lewin on Trusts* 102.

³⁰⁵ Hayton *The Law of Trusts* 93.

³⁰⁶ See Hudson *Equity and Trusts* 197–220 for a detailed discussion of the beneficiary principle.

³⁰⁷ Hayton *The Law of Trusts* 74; Moffat *et al Trusts Law* 121; Riddall *The Law of Trusts* 34; Mowbray *et al Lewin on Trusts* 103.

³⁰⁸ Hayton *The Law of Trusts* 99.

³⁰⁹ Hayton *The Law of Trusts* 75; Moffat *et al Trusts Law* 122; Mowbray *et al Lewin on Trusts* 122.

³¹⁰ Hayton *The Law of Trusts* 108.

³¹¹ Perpetuities and Accumulations Act 1964 and Perpetuities and Accumulations Act 2009; Hayton *The Law of Trusts* 106.

accumulations, income can be accumulated and added to capital for one of six possible periods set out in the Law of Property Act³¹² and the Perpetuities and Accumulations Act.³¹³

2.3.4.2 Scotland

The vast majority of trusts are created deliberately³¹⁴ and may be either *inter vivos*, in other words a trust set up while the settlor³¹⁵ is alive, or a testamentary trust, which is set up by the settlor's will on his or her death.³¹⁶ In the case of a testamentary trust, the trustees are nominated and the trust assets identified in the will.³¹⁷ Testamentary trusts must be in writing, because wills must be in writing.³¹⁸ Although registration is not a requirement for a valid testamentary trust, most trusts are registered because the wills are registered.³¹⁹ The trust is, of course, created only on the death of the settlor.³²⁰

In the case of *inter vivos* trusts, two elements are of importance: the declaration of trust and the vesting of property in the trustee. Both elements are required so that the trust does not come into existence until the property is transferred to the trustees.³²¹ The first element, the declaration of trust, typically involves a deed of trust signed by the settlor and delivered to the trustee.³²² The trust purposes,³²³ beneficiaries and trust property are identified in the trust deed and although it is often registered in the Books of Council and Session,³²⁴ this is not a legal requirement. According to Gretton and Steven, if the purposes of a trust "are too indeterminate or too obscure, to be interpreted, the trust will be void 'by reason of uncertainty'".³²⁵ Furthermore, a trust's purpose may not be contrary to public policy.³²⁶ Usually trust property mentioned in the trust deed is nominal and other assets are transferred later to the trust.³²⁷

³¹² Law of Property Act 1925.

³¹³ Hayton *The Law of Trusts* 107.

³¹⁴ Some trusts are created involuntarily, either by statute or by common law (Gretton *et al Property, Trusts and Succession* 322). These trusts fall outside the scope of this research.

³¹⁵ A "truster" is the Scottish term for the person who sets up the trust. The corresponding term in England is "settlor", which is used for consistency throughout this dissertation. (Gretton *et al Property, Trusts and Succession* 332; Gloag and Henderson *The Law of Scotland* 949).

³¹⁶ Gretton *et al Property, Trusts and Succession* 322; Wilson and Duncan *Trusts, Trustees and Executors* 31.

³¹⁷ Gretton *et al Property, Trusts and Succession* 329.

³¹⁸ Gloag and Henderson *The Law of Scotland* 953; Reid in *Principles of European Trust Law* 75.

³¹⁹ Gretton *et al Property, Trusts and Succession* 331.

³²⁰ Gloag and Henderson *The Law of Scotland* 952.

³²¹ Gloag and Henderson *The Law of Scotland* 952; According to Reid, the trust comes into existence on declaration. The settlor is then obliged to transfer the assets to the trustee and the beneficiaries hold rights from that moment forward, although the trust assets are still exposed to the settlor's personal creditors (Reid in *Principles of European Trust Law* 75).

³²² Gloag and Henderson describe the declaration of trust by the settlor and the delivery or communication of the declaration to the trustees who accept office as two judicial acts or steps (Gloag and Henderson *The Law of Scotland* 951). It is submitted that as long as both occur, it does not matter whether they are seen as one or two steps.

³²³ Wilson and Duncan *Trusts, Trustees and Executors* 30.

³²⁴ Reid in *Trusts in Mixed Legal Systems* 26.

³²⁵ Gretton *et al Property, Trusts and Succession* 345; see also Wilson and Duncan *Trusts, Trustees and Executors* 105.

³²⁶ Gretton *et al Property, Trusts and Succession* 345; Wilson and Duncan *Trusts, Trustees and Executors* 108.

³²⁷ Gretton *et al Property, Trusts and Succession* 329.

No special words are used to create a trust.³²⁸ Writing is not a requirement for a valid *inter vivos* trust.³²⁹ In terms of the rule against perpetuities, a trust becomes a bare trust³³⁰ for a beneficiary if the beneficiary was unborn when the trust was formed.³³¹

The appointment of a trustee does not take effect until the trustee has accepted his or her nomination.³³² If none of the trustees accept their nomination, the trust will not usually fail as the settlor, or the court, in appropriate circumstances, may nominate alternative trustees.³³³

2.3.5 Administration of a trust

2.3.5.1 England

The general powers of administration of a trust are placed in the hands of the trustees.³³⁴ In terms of the common law, trustees must act jointly, unless the trust instrument provides otherwise.³³⁵

Everyone of the trustees must act personally, save to the extent that a trustee may delegate to other trustees or agents in terms of the Trustee Act.³³⁶ In terms of the Trustee Act trustees may authorise any person to exercise any or all of their delegable functions as their agent. The trustees' delegable functions consist of any function other than (a) any function relating to whether or in what way any assets of the trust should be distributed; (b) any power to decide whether any fees or other payment due to be made out of the trust funds should be made out of income or capital; (c) any power to appoint a person to be a trustee of the trust; or (d) any power conferred by any other enactment or the trust instrument which permits the trustees to delegate any of their functions or to appoint a person to act as a nominee or custodian.³³⁷ The trustees may not permit an agent to appoint a substitute, to act in circumstances capable of giving rise to a conflict of interest, or restrict the agent's liability to the trustees or any beneficiary.³³⁸ Special rules apply when an agent is authorised to act as asset manager for the trustees, such as that the agreement must be in writing and that trustees must prepare a written policy statement which gives guidance to the agent as

³²⁸ Gretton *et al* *Property, Trusts and Succession* 330; Gloag and Henderson *The Law of Scotland* 591; Wilson and Duncan *Trusts, Trustees and Executors* 23; Reid in *Principles of European Trust Law* 75.

³²⁹ Requirements of Writing (Scotland) Act 1995, s 1(1); Wilson and Duncan *Trusts, Trustees and Executors* 30, 37; Gretton *et al* *Property, Trusts and Succession* 331; Gloag and Henderson *The Law of Scotland* 51; Reid in *Trusts in Mixed Legal Systems* 26; Reid in *Principles of European Trust Law* 75. However, truster/trustee trusts and trusts relating to an interest in land must be in writing.

³³⁰ A bare trust means that the only purpose of the trust is to hold the trust assets for the beneficiary (or beneficiaries in common), who may insist on immediate transfer of the assets to him or her at any time (Gretton *et al* *Property, Trusts and Succession* 324).

³³¹ Law Reform (Miscellaneous Provisions) (Scotland) Act 1968 s 18.

³³² Wilson and Duncan *Trusts, Trustees and Executors* 294; Reid in *Principles of European Trust Law* 74.

³³³ Wilson and Duncan *Trusts, Trustees and Executors* 301.

³³⁴ Moffat *et al* *Trusts Law* 434; Trustee Act (1925) Pt II.

³³⁵ Waters *Waters' Law of Trusts in Canada* ch 18.1 11; Thomas and Hudson *The Law of Trusts* 342–343; Hudson *Equity and Trusts* 348.

³³⁶ Trustee Act (2000); Hayton *The Law of Trusts* 142; Riddall *The Law of Trusts* 317; Hudson *Equity and Trusts* 353.

³³⁷ Trustee Act (2000) s 11(2).

³³⁸ Trustee Act (2000) ss 14(2) and (3).

to how his or her functions must be performed.³³⁹ While the agent acts for the trust, the trustees must keep under review the arrangements under which the agent acts and how those arrangements are being put into effect. They must also consider whether there is a need to exercise any power of intervention that they have and exercise such a power if necessary. "Power of intervention" includes a power to give directions and to revoke the authorisation or appointment.³⁴⁰ The provisions of the Trustee Act set out above may be restricted or excluded by the trust instrument.³⁴¹

The Trustee Act³⁴² provides that an individual trustee may delegate the execution or exercise of all or any of the trusts, powers and discretions vested in him or her as trustee.³⁴³ The delegation must be given in terms of a written power of attorney and may continue for a maximum of twelve months.³⁴⁴ The trustee, however, remains liable for the acts of the person to whom he has delegated. A trustee may also delegate his or her discretion in terms of the trust deed.³⁴⁵

2.3.5.2 Scotland

The general principles regarding trust administration are that trustees must perform their duties personally and, where there is more than one trustee, must act as a body, on the basis that each individual takes responsibility for every step of the administration of the trust. Due to practical considerations, these principles have been relaxed in certain respects.³⁴⁶

The trust deed may lay down certain rules for the conduct of the trust's administration, but in the absence of rules in the trust deed certain default rules will apply. Thus, these default rules determine that a quorum of trustees must be present in order for a valid meeting to be held and that the majority of trustees are a quorum.³⁴⁷ Furthermore, decisions are made by majority vote,³⁴⁸ but the majority must be the majority of all the trustees and not just those present at the meeting.³⁴⁹ In cases where trustees are appointed on a basis of joint tenure or if they are designated *sine qua non*, all of these trustees must participate, or at least concur, in all acts of the administration of the trust.³⁵⁰ All trustees must be "consulted" and a failure to consult may lead to an invalid decision.³⁵¹ All that is required for "consultation" to take

³³⁹ Trustee Act (2000) s 15.

³⁴⁰ Trustee Act (2000) s 22.

³⁴¹ Trustee Act (2000) s 26. For a general discussion on the delegation of trustees' duties, see Hudson *Equity and Trusts* 480–485.

³⁴² Trustee Act (1925) which was amended by the Trustee Delegation Act 1999.

³⁴³ Trustee Act (1925) s 25.

³⁴⁴ The power of attorney must be attested to by a witness (Hayton *The Law of Trusts* 156).

³⁴⁵ Moffat *et al Trusts Law* 528.

³⁴⁶ Wilson and Duncan *Trusts, Trustees and Executors* 362. The authors do not list the practical considerations, but one can think of the practical difficulties involved in having the day to day affairs of a trust dealt with by all the trustees, especially where there are many trustees involved, as an example of these practical considerations.

³⁴⁷ Wilson and Duncan *Trusts, Trustees and Executors* 365; Trusts (Scotland) Act (1921) s 3(c).

³⁴⁸ Garden and Mackintosh *Trusts and Estates in Scotland 2009/2010* 5; Wilson and Duncan *Trusts, Trustees and Executors* 362.

³⁴⁹ Gretton *et al Property, Trusts and Succession* 343.

³⁵⁰ Wilson and Duncan *Trusts, Trustees and Executors* 362.

³⁵¹ Wilson and Duncan *Trusts, Trustees and Executors* 359. These arrangements are rare in practice.

place, is for the trustees to be notified of a meeting that is to take place and that fair notice be given,³⁵² but even this is unnecessary if it would be pointless or impossible to do so.³⁵³ Wilson and Duncan insist, however, that in impractical or impossible cases, consultation by written or telephonic communication must take place.³⁵⁴

If trustees dispose of trust property, a dissenting trustee has a duty to sign the documents required for the disposition to take place, but it is uncertain whether, as a matter of conveyancing law, the signature of the majority is adequate.³⁵⁵

Regarding the rights of third parties, the Trusts (Scotland) Act 1921 provides as follows:

“Any deed bearing to be granted by the trustees under any trust, and in fact executed by a quorum of such trustees in favour of any person other than a beneficiary or a co-trustee under the trust where such person has dealt onerously and in good faith shall not be void or challengeable on the ground that any trustee or trustees under the trust was or were not consulted in the matter, or was or were not present at any meeting of trustees where the same was considered, or did not consent to or concur in the granting of the deed, or on the ground of any other omission or irregularity of procedure on the part of the trustees or any of them in relation to the granting of the deed.”³⁵⁶

Trustees may appoint factors and law agents and pay them suitable remuneration, unless such power is at variance with the terms of the trust deed or purpose of the trust.³⁵⁷ In addition and at common law, trustees have the power to appoint agents. If this power is exercised properly, it is not regarded as a delegation of functions which trustees are obliged to perform personally. The power may be exercised if a person of reasonable prudence dealing with his or her own affairs would consider the employment of an agent appropriate.³⁵⁸

2.4 Canada

2.4.1 Introduction

The French were the first to colonise what is now known as Canada, but were followed by the British. In the clashes between these two nations, the British eventually prevailed.³⁵⁹ Today, Canada is a constitutional monarchy, which recognises the Queen of England as the head of the state, although this recognition is largely symbolic. Under the Constitution Act 1867, a federal government was created with various provincial governments, each having certain legislative powers. For example, the federal government has unlimited powers of taxation, but provinces are allowed to levy direct taxation on income earned in the province,

³⁵² Wilson and Duncan *Trusts, Trustees and Executors* 363.

³⁵³ Gretton *et al Property, Trusts and Succession* 344.

³⁵⁴ Wilson and Duncan *Trusts, Trustees and Executors* 363.

³⁵⁵ Gretton *et al Property, Trusts and Succession* 344.

³⁵⁶ Trusts (Scotland) Act (1921) s 7.

³⁵⁷ Trusts (Scotland) Act (1921) s 4(f).

³⁵⁸ Wilson and Duncan *Trusts, Trustees and Executors* 367.

³⁵⁹ Tjaden (2005) *AALL Spectrum* 10. See also Coetzee 'n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 198-201.

as well as worldwide income earned by residents of the particular province.³⁶⁰ Furthermore, the law of trusts falls under the jurisdiction of each province.³⁶¹ Nowadays Canada has ten provinces and three territories. Because of Canada's history, private law in the province of Québec is based on the French civil law tradition and therefore differs from the other provinces, which draw on the English common law.³⁶² Québec may therefore be described as a mixed jurisdiction, applying "civil law" for provincial matters, but applying statutory and "common" law for federal matters.³⁶³ In the following paragraphs a distinction will therefore be made between what is called "the rest of Canada" and "Québec".

2.4.2 A brief history

2.4.2.1 The rest of Canada

The British who settled in Canada brought the common law, and therefore also the trust concept, with them. By the time the trust was used in Canada by the settlers in the early nineteenth century, though, it was virtually a finished product.³⁶⁴ In that sense the history of the trust in England is also the history of the trust in Canada.

2.4.2.2 Québec

British settlers in Canada introduced the trust concept to Canada and there is little doubt that the original model of the trust in Québec was the English trust.³⁶⁵ Although the first Civil Code³⁶⁶ did not recognise trusts, trusts were used in practice and therefore legislation was soon enacted to rectify the omission. Although no contemporary documentation exists, the enactment of the legislation may have been brought about by a decision of the Privy Council to the effect that a trust did not form part of the law of Lower Canada.³⁶⁷ Thus the first Civil Code was amended to incorporate the trust into Québec law. Since that time the relevant provisions of the first Civil Code was replaced by a number of sections in the Civil Code of Québec.³⁶⁸

³⁶⁰ Arnold in *Comparative Income Taxation: A Structural Analysis* 23; Anonymous *Canadian Master Tax Guide* para 755.

³⁶¹ Waters *Waters' Law of Trusts in Canada* ch 13.III 2.

³⁶² Tjaden "Researching Canadian Law" <http://www.nyulawglobal.org/globalex/Canada1.htm#_The_Canadian_Legal_System> (accessed on 08/04/2011).

³⁶³ Tjaden (2005) *AALL Spectrum* 10.

³⁶⁴ Waters *Waters' Law of Trusts in Canada* ch 1.III 1.

³⁶⁵ Cantin Cumyn in *Trusts in Mixed Legal Systems* 73. See also Coetzee 'n *Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* 202-206 for a discussion of the development of the trust in Québec.

³⁶⁶ Civil Code of Lower Canada

³⁶⁷ Cantin Cumyn in *Trusts in Mixed Legal Systems* 74. Arts 1256 to 1298 of the Civil Code of Québec SQ 1991 ch 64, which has been in force since 1994.

³⁶⁸ Arts 1256 to 1298 of the Civil Code of Québec SQ 1991 ch 64, which has been in force since 1994.

2.4.3 Definitions

2.4.3.1 The rest of Canada

Authors agree that it is a difficult task to define a trust and that most definitions emphasise a particular aspect of a trust. Most Canadian texts adopt the definitions offered by authors on English law,³⁶⁹ such as the definitions of Underhill and Hayton, Lewin and Keeton and Sheridan.³⁷⁰

The federal Canadian Government is a signatory to The Hague Convention on Trusts and a number of provinces³⁷¹ have adopted legislation to bring the Convention in force.³⁷² The definition in the Hague Convention on Trusts will therefore also be of importance in Canadian law.

The Income Tax Act³⁷³ does not contain a comprehensive definition of what a trust is.³⁷⁴ Instead it provides that:

“In this Act, a reference to a trust or estate (in this subdivision referred to as a “trust”) shall, unless the context otherwise requires, be read to include a reference to the trustee, executor, administrator, liquidator of a succession, heir or other legal representative having ownership or control of the trust property, but, except for the purposes of this subsection, subsection (1.1), subparagraph (b)(v) of the definition “disposition” in subsection 248(1) and paragraph (k) of that definition, a trust is deemed not to include an arrangement under which the trust can reasonably be considered to act as agent for all the beneficiaries under the trust with respect to all dealings with all of the trust’s property unless the trust is described in any of paragraphs (a) to (e.1) of the definition “trust” in subsection 108(1).”³⁷⁵

It has been contended that, in order to establish whether a trust exists for tax purposes, the trust law requirements for a valid trust³⁷⁶ must be met.³⁷⁷ Where, however, a trust is governed by foreign law, the rights and obligations created by the foreign law must be taken into account in determining whether the relationship is regarded as a trust for income tax purposes.³⁷⁸ In *Peter Sommerer v Her Majesty the Queen*, the Tax Court of Canada had to decide whether an Austrian Private Foundation was a trust for purposes of the Income Tax

³⁶⁹ See 2.3.2.1 above.

³⁷⁰ *Waters Waters' Law of Trusts in Canada* ch 1.II 1; Oosterhoff *et al* *Oosterhoff on Trusts: Text, Commentary and Materials* 13.

³⁷¹ British Columbia, Alberta, Saskatchewan, Manitoba, New Brunswick, Newfoundland and Labrador, Prince Edward Island and Nova Scotia. Québec has not adopted the Convention, but relies on the conflict of laws rules as well as arts 3107 and 3108 of the Civil Code of Québec SQ 1991 ch 64 to resolve disputes (Brown in *Topical Analysis* para 1.3).

³⁷² *Waters Waters' Law of Trusts in Canada* ch 29.I 4; Oosterhoff *et al* *Oosterhoff on Trusts: Text, Commentary and Materials* 52.

³⁷³ Income Tax Act RSC 1985 (5th supp) ch 1.

³⁷⁴ Brown (2001–2002) 21 *ETPJ* 1 3.

³⁷⁵ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(1). A testamentary trust is defined in s 108(1).

³⁷⁶ See ch 2.4.5.1.

³⁷⁷ *Danon Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 80.

³⁷⁸ Brown in *Topical Analysis* para 1.4.1.

Act. The court held that it was required to determine the essential elements of a trust in terms of Canadian private law and compare it to the elements of the foreign arrangement to determine whether it can be treated as a trust under Canadian law.³⁷⁹

2.4.3.2 Québec

The Civil Code of Québec does not contain a section which *per se* defines a trust. It does, however, describe the trust by providing that:

“A trust results from an act whereby a person, the settlor, transfers property from his patrimony to another patrimony constituted by him which he appropriates to a particular purpose and which a trustee undertakes, by his acceptance, to hold and administer.”³⁸⁰

and

“The trust patrimony, consisting of the property transferred in trust, constitutes a patrimony by appropriation, autonomous and distinct from that of the settlor, trustee or beneficiary and in which none of them has any real right.”³⁸¹

These articles are discussed in greater detail below.³⁸²

In terms of the federal Income Tax Act,³⁸³ certain trusts that are governed by Québec law, are specifically regarded as trusts for income tax purposes. The relevant provision, as far as is relevant for present purposes, reads as follows:

“For the purposes of this Act, if property is subject to an institution or arrangement that is described by this subsection and that is governed by the laws of the Province of Québec, the following rules apply in respect of the property:

- (a) if at any time property is subject to a usufruct, right of use or habitation, or substitution,
 - (i) the usufruct, right of use or habitation, or substitution, as the case may be, is deemed to be at that time
 - (A) a trust, and
 - (B) where the usufruct, right of use or habitation, or substitution, as the case may be, is created by will, a trust created by will,
 - (ii) ... and
 - (iii) ...;
- (b) an arrangement (other than a partnership, a qualifying arrangement or an arrangement

³⁷⁹ *Peter Sommerer v Her Majesty the Queen* 2011 TCC 212 para 60. In this case, the court did not decide whether the Austrian Private Foundation was a trust. It held that relationship between the founder of the Private Foundation, the Private Foundation itself and the beneficiaries of the Private Foundation constituted a trust (see para 82). This finding was criticized on appeal, although the court did not express a final opinion on this point (*Her Majesty the Queen v Peter Sommerer* 2012 FCA 207 paras 38–43).

³⁸⁰ Civil Code of Québec SQ 1991 ch 64 art 1260.

³⁸¹ Civil Code of Québec SQ 1991 ch 64 art 1261.

³⁸² See ch 2.4.4.

³⁸³ Income Tax Act RSC 1985 (5th supp) ch 1 s 248(3).

that is a trust determined without reference to this paragraph) is deemed to be a trust and property subject to rights and obligations under the arrangement is, if the arrangement is deemed by this paragraph to be a trust, deemed to be held in trust and not otherwise, where the arrangement

- (i) is established before October 31, 2003 by or under a written contract that
 - (A) is governed by the laws of the Province of Québec, and
 - (B) provides that, for the purposes of this Act, the arrangement shall be considered to be a trust, and
- (ii) creates rights and obligations that are substantially similar to the rights and obligations under a trust (determined without reference to this subsection);
- (c) if the arrangement is a qualifying arrangement,
 - (i) the arrangement is deemed to be a trust,
 - (ii) any property contributed at any time to the arrangement by an annuitant, a holder or a subscriber of the arrangement, as the case may be, is deemed to have been transferred, at that time, to the trust by the contributor, and
 - (iii) property subject to rights and obligations under the arrangement is deemed to be held in trust and not otherwise;
- (d) a person who has a right (whether immediate or future and whether absolute or contingent) to receive all or part of the income or capital in respect of property that is referred to in paragraph (a) or (b) is deemed to be beneficially interested in the trust; and
- (e) ...“

Under Québec tax law,³⁸⁴ a trust is not defined either, but it provides that

“a trust, wherever it is created, or a succession, in this Title referred to as a ‘trust’, also includes the trustee or other legal representative having ownership or control of the trust property.”

2.4.4 Legal nature and key features

2.4.4.1 The rest of Canada

Waters names three essential features of the trust in Canada. The first is that the trustee and beneficiary stand in a fiduciary relationship with each other. The trustees hold the title to and manage the trust property, but not for their own benefit. It is the beneficiaries who are entitled to the enjoyment of the trust property. Trustees therefore have a duty to act in the best interests of the beneficiaries.³⁸⁵ The trustee’s fiduciary duty means that he has the duty to account to the beneficiary for all that he does with the trust property and in his or her capacity as trustee. Hence the trustee must avoid a conflict of interest and must perform his or her duties personally (subject to certain exceptions).³⁸⁶ Trustees also have a duty to act honestly, prudently and diligently and may not make unauthorised profits.³⁸⁷

³⁸⁴ Taxation Act RSQ 1–3 s 646. Testamentary trusts are defined in s 677.

³⁸⁵ Waters *Waters' Law of Trusts in Canada* ch 1.IV 1–3; Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 14.

³⁸⁶ Waters *Waters' Law of Trusts in Canada* ch 3.I 1.

³⁸⁷ Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 72.

Agents also stand in a fiduciary relationship with others to some degree.³⁸⁸ There are, however, important differences between an agent and a trustee. For example, an agent acts on instructions from his or her principal. A trustee is not an agent of the settlor, or the beneficiaries.³⁸⁹ The trustee performs an office.³⁹⁰ Furthermore, an agent merely has possession of the property and contracts on behalf of the principal. A trustee, on the other hand, is the legal owner of the property.³⁹¹

The second essential feature of the trust is that of the dual ownership of the trustee and the beneficiary. The trustee holds the legal interest in the trust property, while the beneficiary holds the equitable interest in the trust property.³⁹² Regarding the nature of the beneficiary's interest, it may be said that the beneficiary has both proprietary and personal rights. For example, the beneficiary has a personal right against the trustee for the proper administration of the trust. On the other hand, the proprietary aspect of the beneficiary's right includes the right to demand that the trust comes to an end and that the property be distributed to him or her (or them if they are in agreement) provided that the beneficiary(ies) is *sui juris*.³⁹³ Furthermore, a beneficiary has a right to trace the trust property. Thus, depending on the situation, the proprietary aspects of a beneficiary's rights may dominate.³⁹⁴ The nature of a discretionary beneficiary's right is discussed below.

The third essential feature is said to flow from the second, namely that the trustee holds the trust property in a separate estate from his or her personal estate. The implication is that the trustee's private creditors cannot lay claim to the trust assets, which are held in a separate estate by the trustee.³⁹⁵

A discretionary trust is one in which the trustees have a duty to distribute income or capital between the beneficiaries as the trustees deem fit.³⁹⁶ A trust must be distinguished from a power, for example, the power of appointment. The power of appointment is a power given to a person to determine who the recipients of certain property are to be. In the case of a trust, the trustees are obliged to deal with the property as set out in the trust instrument. For example, in the case of a discretionary trust, the trustees are obliged to distribute the income or capital, but have a discretion regarding the amount a beneficiary will receive. In the case of a power of appointment, the holder of the power is entitled, but not obliged, to exercise the power.³⁹⁷ It may be said that the class of beneficiaries as a whole have a

³⁸⁸ *Waters Waters' Law of Trusts in Canada* ch 3.I 3; Oosterhoff *et al* *Oosterhoff on Trusts: Text, Commentary and Materials* 87.

³⁸⁹ There is authority for the proposition that in cases where the beneficiaries control the trustees, the relationship is one of agency, rather than trust. The extent of the beneficiaries' control is, however, unclear. If the settlor retains a certain amount of control over the trustees, it may be one of the factors which indicate that the parties did not intend to create a trust, but rather an agency relationship. Once again the degree of control is unclear (*Waters Waters' Law of Trusts in Canada* ch 3.III 4–5).

³⁹⁰ *Waters Waters' Law of Trusts in Canada* ch 3.III 1.

³⁹¹ *Waters Waters' Law of Trusts in Canada* ch 3.III 3; Oosterhoff *et al* *Oosterhoff on Trusts: Text, Commentary and Materials* 88.

³⁹² *Waters Waters' Law of Trusts in Canada* ch 1.IV 2.

³⁹³ Under the rule in *Saunders v Vautier* (1841) 4 Beav 115.

³⁹⁴ Oosterhoff *et al* *Oosterhoff on Trusts: Text, Commentary and Materials* 27.

³⁹⁵ *Waters Waters' Law of Trusts in Canada* ch 1.IV. 3.

³⁹⁶ *Waters Waters' Law of Trusts in Canada* ch 2.IX 1.

³⁹⁷ *Waters Waters' Law of Trusts in Canada* ch 3 VII 1; Oosterhoff *et al* *Oosterhoff on Trusts: Text, Commentary and Materials* 16.

proprietary interest in the trust property; an individual discretionary beneficiary does not have such an interest, as the trustees might not exercise their discretion in his or her favour.³⁹⁸ Thus, until a beneficiary under a discretionary trust has property distributed to him or her, the beneficiary cannot be said to have an interest in the trust property. However, a discretionary beneficiary arguably has a *quasi*-property interest, since the beneficiary may trace property in the hands of third persons (other than *bona fide* purchasers for value without notice). Since the proprietary interest must rest somewhere, one may conclude that the interest resides in the beneficiaries.³⁹⁹

A trust is not a juristic person.⁴⁰⁰ For purposes of the federal Income Tax Act,⁴⁰¹ though, a trust is regarded as a taxpayer and therefore taxed as an individual.

2.4.4.2 Québec

In terms of the Civil Code of Québec, a trust is a separate and autonomous patrimony to which neither the trustee, settlor nor beneficiary has any real right.⁴⁰² Article 1261 of the Québec Civil Code provides that the “trust patrimony, consisting of the property transferred in trust, constitutes a patrimony by appropriation, autonomous and distinct from that of the settlor, trustee or beneficiary and in which none of them has any real right.” According to Cantin Cumyn, this means that a trust is a separate entity, which although it is not classified as a juristic person, operates in the same way.⁴⁰³ She has argued that the trust is a *sujet de droit*, a subject of law or of rights (and obligations), which differs from a juristic person and can be classified as an intermediate entity (that is, between a juristic person and a person without juristic personality).⁴⁰⁴ The trust may therefore be regarded as the owner of the trust assets⁴⁰⁵ and may enter into contracts and incur debts.⁴⁰⁶ Waters agrees that the provisions of the Civil Code make it impossible to argue that the trust is a juristic person. He mentions two other possibilities, namely Cantin Cumyn’s *sujet de droit* argument and the argument that the trustee has two separate patrimonies and that the trustee is the owner of the trust assets in his or her trust patrimony. Waters seems to dismiss the latter possibility and instead argues that the relevant article in the Civil Code means that the trust patrimony does not belong to anyone, in other words, the trust assets have no owner.⁴⁰⁷ It seems as if this issue has not yet been resolved by any court decisions or legislation.

³⁹⁸ Oosterhoff *et al* *Oosterhoff on Trusts: Text, Commentary and Materials* 15.

³⁹⁹ Oosterhoff *et al* *Oosterhoff on Trusts: Text, Commentary and Materials* 32.

⁴⁰⁰ Waters *Waters' Law of Trusts in Canada* ch 13.II 3.

⁴⁰¹ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(2).

⁴⁰² Trustee Delegation Act 1999, art 1261.

⁴⁰³ Cantin Cumyn in *Trusts in Mixed Legal Systems* 76; Cantin Cumyn in *Re-imagining the Trust* 22.

⁴⁰⁴ Waters *Waters' Law of Trusts in Canada* ch 28.III 2.

⁴⁰⁵ This argument is augmented by art 1260 of the Civil Code of Québec SQ 1991 ch 64 which provides that the trustee *transfers* property from his or her own patrimony to another patrimony, which the trustee undertakes to hold and administer. See also De Waal (2001) 12 *Stell LR* 63 80.

⁴⁰⁶ Cantin Cumyn in *Trusts in Mixed Legal Systems* 76.

⁴⁰⁷ Waters *Waters' Law of Trusts in Canada* chs 28.I 5 and 28.III 2.

Even before the enactment of the current provisions regarding trusts in the Civil Code, the courts have held that the notion of dual ownership did not form part of the law of Québec.⁴⁰⁸

The settlor has the duty to transfer the assets to the trust.⁴⁰⁹ He may, however, reserve the right to receive the fruits and revenues or even, where such is the case, the capital of the trust, or share in the benefits it procures.⁴¹⁰ According to Cantin Cumyn, this provision means that although the settlor may be a beneficiary, he or she may not be the sole beneficiary of the trust. A settlor may act as a trustee of the trust, but not the sole trustee, provided that the other trustee is not a beneficiary. Similarly, a beneficiary may act as a trustee, but he or she must act jointly with a person who is neither the settlor, nor a beneficiary.⁴¹¹ According to Waters, a trust in which the settlor retains considerable control over the trust assets is not allowed as it is understood as being inconsistent with a genuine intention to create a trust.⁴¹²

Since the trustee is not the owner of the trust property, one may ask what his or her role is. The Civil Code provides that he or she is charged with seeing to the appropriation of the property and the administration of the trust patrimony.⁴¹³

The beneficiary has no real rights in respect of the trust property⁴¹⁴ and his or her right has been recognised as that of a creditor. A beneficiary's claim is satisfied from the trust patrimony and not from the trustee's personal patrimony. The latter is immune to claims from creditors.⁴¹⁵

Together with the settlor, the beneficiaries have a supervisory role over the trustee.⁴¹⁶ For example, they may take action against the trustee to compel him or her to perform his or her obligations or to perform any act which is necessary in the interest of the trust, to enjoin him or her to abstain from any action harmful to the trust or to have him or her removed.⁴¹⁷

Trustees have duties which may be described as fiduciary,⁴¹⁸ such as the duty to act with prudence and diligence and also to act honestly and faithfully in the best interest of the beneficiary.⁴¹⁹ The trustee must avoid a conflict of interest and may not exercise his or her powers in his or her own interest or that of a third person.⁴²⁰ Neither may a trustee use trust property or information he or she obtains by reason of his or her trusteeship for his or her

⁴⁰⁸ *Royal Trust Co v Tucker* [1982] 1 SCR 250.

⁴⁰⁹ Civil Code of Québec SQ 1991 ch 64 art 1260.

⁴¹⁰ Civil Code of Québec SQ 1991 ch 64 art 1280.

⁴¹¹ Civil Code of Québec SQ 1991 ch 64 art 1275.

⁴¹² Waters *Waters' Law of Trusts in Canada* ch 28.III 3.

⁴¹³ Civil Code of Québec SQ 1991 ch 64 art 1265; De Waal (2001) 12 *Stell LR* 63 80.

⁴¹⁴ Civil Code of Québec SQ 1991 ch 64 art 1260.

⁴¹⁵ Cantin Cumyn in *Trusts in Mixed Legal Systems* 78; Civil Code of Québec SQ 1991 ch 64 art 1319; Waters *Waters' Law of Trusts in Canada* ch 28.III 5.

⁴¹⁶ Civil Code of Québec SQ 1991 ch 64 art 1287.

⁴¹⁷ Civil Code of Québec SQ 1991 ch 64 art 1290.

⁴¹⁸ De Waal (2001) 12 *Stell LR* 63 81.

⁴¹⁹ Civil Code of Québec SQ 1991 ch 64 art 1309.

⁴²⁰ Civil Code of Québec SQ 1991 ch 64 art 1310.

benefit, except with the consent of the beneficiary or unless it results from the law or the act constituting the trust.⁴²¹

2.4.5 Requirements for the formation of a valid trust

2.4.5.1 The rest of Canada

Both *inter vivos* and testamentary trusts are found in Canada.⁴²² Most trusts are formed expressly by the settlor.⁴²³

A trust is usually constituted when the three requirements for a valid trust are met and the property has been transferred to the trustees.⁴²⁴ Therefore, if the three requirements are present, but the property has not been transferred yet and the trustees or beneficiaries cannot oblige the settlor to transfer the property, no valid trust has come into existence.⁴²⁵ In the case of an *inter vivos* trust, property may be transferred to the trustees by the settlor, in which case the specific form that the transfer must take in order to be effective, will be determined by the type of property. On the other hand, the trustee may declare himself or herself a trustee of the property, in which case no transfer of property is needed.⁴²⁶ A testamentary trust takes effect upon the testator's death.⁴²⁷

The three requirements for a valid trust are:⁴²⁸

- (a) The words used to create the trust must be imperative, in other words, the settlor must use language which clearly indicates that a trust must be formed. However, it is unnecessary to use any technical words. What must be clear, though, is the settlor's intention, that is, the intention to create a trust.⁴²⁹ The intention to form an *inter vivos* trust may be expressed in writing or orally.⁴³⁰ In the case of a testamentary trust, which forms part of the settlor's will, writing must be used.⁴³¹ Regarding formalities, some provinces still apply the Statute of Frauds⁴³² or legislation with a similar effect.⁴³³

⁴²¹ Civil Code of Québec SQ 1991 ch 64 art 1314.

⁴²² Waters *Waters' Law of Trusts in Canada* ch 2.IX 1; Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 14.

⁴²³ Resulting, constructive and implied trusts are also found in Canadian law and so too are statutory trusts (Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 17 and 20), but these will not be further explored in this research.

⁴²⁴ To this Oosterhoff (Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 162) adds that the parties to the trust must be capacitated.

⁴²⁵ Waters *Waters' Law of Trusts in Canada* ch 2.III 1. If valuable consideration was given by the beneficiary for the trust, the settlor can be compelled to perform under the normal rules of the law of contract. (Waters *Waters' Law of Trusts in Canada* ch 6.I 1; Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 17.)

⁴²⁶ Waters *Waters' Law of Trusts in Canada* ch 6.IV 1; Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 16, 219.

⁴²⁷ Waters *Waters' Law of Trusts in Canada* ch 17.I 1.

⁴²⁸ Waters *Waters' Law of Trusts in Canada* ch 5.I 1.

⁴²⁹ Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 167.

⁴³⁰ Waters *Waters' Law of Trusts in Canada* ch 5.II 1; Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 16.

⁴³¹ Waters *Waters' Law of Trusts in Canada* ch 5.II 2. Secret and half-secret trusts are enforced in Canada, provided certain requirements are met (Waters *Waters' Law of Trusts in Canada* ch 7.IV 1).

⁴³² Statute of Frauds 1677.

The result of this legislation is that, generally speaking, trusts of land or of interests in land must be evidenced in writing. The grant or assignment of an equitable interest in trusts must also be in writing, irrespective of the nature of the trust property.⁴³⁴

- (b) The trust property (or subject matter of the trust) must be certain, meaning that the property which is to be held in trust must be clearly described, so that it can be ascertained definitively. Furthermore, the shares in the property to which each of the beneficiaries are entitled, must also be clear.⁴³⁵
- (c) The objects of the trust must be certain. Thus the beneficiaries of the trust must be certain. A trust for a non-charitable purpose (that is, a trust not for the benefit of persons, but for a specific purpose) is void, subject to certain exceptions.⁴³⁶

Furthermore, a trust will be invalid if its terms are contrary to public policy, or if it contravenes common law or any statute.⁴³⁷ Canadian law also contains a perpetuity rule and a rule against perpetual duration.⁴³⁸

2.4.5.2 Québec

Only express trusts are recognised in Québec. Trusts may be formed *inter vivos* by way of a gift or an onerous contract,⁴³⁹ or by will.⁴⁴⁰ The trust is formed if the settlor transfers property from his or her patrimony to the trust. The trustee undertakes, by his or her acceptance, to hold and administer the trust property for the purpose appropriated by the settlor.⁴⁴¹ Thus the trust is constituted only upon the acceptance of the trustee or of one of the trustees, if there are several.⁴⁴² In the case of a testamentary trust, the effects of the trustee's acceptance are retroactive to the date of death.⁴⁴³

Usually trusts are constituted gratuitously and therefore have to meet the formal requirements of a gift or a will. The exception to this rule is business trusts, which are constituted by an onerous contract. If the general rules applicable to contracts are met, no

⁴³³ The Statute of Frauds 1677 is in force in Alberta, Saskatchewan, Newfoundland and the territories (see 2.4.1). The Statute of Frauds has been legislatively adopted in Ontario, Nova Scotia and New Brunswick. Prince Edward Islands have adopted the Statute of Frauds, but without the relevant parts applicable to trusts. British Columbia has repealed the Statute of Frauds and has enacted legislation which alters the relevant rules. Manitoba has repealed the Statute of Frauds. (Waters *Waters' Law of Trusts in Canada* ch 7.II 1).

⁴³⁴ Waters *Waters' Law of Trusts in Canada* ch 7.I 1.

⁴³⁵ Waters *Waters' Law of Trusts in Canada* ch 5.III 1; Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 171.

⁴³⁶ Waters *Waters' Law of Trusts in Canada* ch 5.IV 4; Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 179.

⁴³⁷ Waters *Waters' Law of Trusts in Canada* ch 2.IV 1.

⁴³⁸ Waters *Waters' Law of Trusts in Canada* ch 8.IV.

⁴³⁹ "Onerous contract" means "bilateral exchange" (Waters *Waters' Law of Trusts in Canada* ch 28.III 2).

⁴⁴⁰ Civil Code of Québec SQ 1991 ch 64 art 1262, which also provides for a trust to be formed by operation of law. It has been suggested that a trust cannot be formed by unilateral declaration in terms of Québec law. (Waters *Waters' Law of Trusts in Canada* ch 28.III 3).

⁴⁴¹ Civil Code of Québec SQ 1991 ch 64 art 1260.

⁴⁴² Waters *Waters' Law of Trusts in Canada* ch 28.III 3.

⁴⁴³ Civil Code of Québec SQ 1991 ch 64 art 1264.

further formalities are required.⁴⁴⁴ However, for all trusts the transfer of the property to the trust must also be valid.⁴⁴⁵

2.4.6 Administration of a trust

2.4.6.1 The rest of Canada

All the trustees must act jointly, unless the trust instrument provides otherwise.⁴⁴⁶ In other words, their decisions must be unanimous and if one trustee does not agree with the others, a deadlock arises. One way of breaking the deadlock is to approach the court for direction, although this remedy may be of limited use as the courts are hesitant to interfere with the trustees' exercising of their duties.⁴⁴⁷ A trustee may delegate his or her duties to other trustees under the same circumstances as those required for delegation to others.⁴⁴⁸

The general rule is, therefore, that trustees must act personally and may not delegate their functions to others.⁴⁴⁹ However, under certain circumstances, the trustees are entitled to delegate their functions, although they will remain responsible for making all decisions. These circumstances are:

- (a) if the trust instrument or statute expressly permits it;
- (b) if the duties are not required to be performed personally;
- (c) where there is no other possible way for the trustee to perform, that is, it is necessary; and
- (d) it is common business practice to do so.⁴⁵⁰

Waters also acknowledges that trustees may delegate their functions, but formulate the circumstances under which they may do so as follows:

“[W]henever the power, discretion, or duty assigned to the trustee requires that a policy decision be made, the trustee must make it himself. A policy decision is one which, if dispositive, determines how much and at what time a beneficiary takes; if administrative, it directly affects the likelihood of the trust's object or purpose being achieved.”⁴⁵¹

Trustees may never delegate all of their duties as it would amount to an abdication of responsibility.⁴⁵² However, legislation in certain provinces enables a trustee, who is going to

⁴⁴⁴ Waters *Waters' Law of Trusts in Canada* ch 28.III 4.

⁴⁴⁵ Cantin Cumyn in *Trusts in Mixed Legal Systems* 77.

⁴⁴⁶ Waters *Waters' Law of Trusts in Canada* ch 18.I 4.

⁴⁴⁷ Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 935.

⁴⁴⁸ Waters *Waters' Law of Trusts in Canada* ch 18.I 4.

⁴⁴⁹ Waters *Waters' Law of Trusts in Canada* ch 18.I 1.

⁴⁵⁰ Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 950.

⁴⁵¹ Waters *Waters' Law of Trusts in Canada* ch 18.I 2.

⁴⁵² Oosterhoff *et al Oosterhoff on Trusts: Text, Commentary and Materials* 950.

be absent from the province, to delegate all of his or her functions.⁴⁵³ Some states also enacted legislation to enable trustees to employ certain agents, for example solicitors or bank managers.⁴⁵⁴

2.4.6.2 Québec

The trustee has full administration of the trust property.⁴⁵⁵ He therefore has the control and the exclusive administration of the trust patrimony, and the titles relating to the property of which it is composed are drawn up in his or her name. The trustee can exercise all the rights pertaining to the patrimony and may take any proper measure to secure its appropriation.⁴⁵⁶

If there is more than one trustee, a majority of them may act, unless they are required by law to act jointly or in a determined proportion.⁴⁵⁷ It may be that the trustees cannot act by majority, because of an impediment or the systematic opposition of some of them. In such a case the others may act for conservatory acts, or a trustee may even act alone (with authorisation from the court) when immediate action is required. If the situation persists and impairs the administration, the court may intervene to resolve the situation.⁴⁵⁸

Trustees are solidarily liable for their administration, unless their duties have been divided by law, the act or the court and the division has been respected, in which case each trustee is liable for his or her own administration only.⁴⁵⁹

A trustee may delegate his or her duties or be represented by a third person for specific acts, but may not generally delegate the conduct of the administration or the exercise of a discretionary power, except to his or her co-trustees. A trustee is accountable for the person selected by him or her if, *inter alia*, he or she was not authorised to make the selection. If the trustee was so authorised, he is accountable only for the care with which he selected the person and gave the instructions.⁴⁶⁰

2.5 The Netherlands

2.5.1 Introduction

The Dutch legal system is based on the civilian system of law and makes use of a civil code.⁴⁶¹ The English law trust is not traditionally found in Dutch law. The reasons for absence of the English trust in civil law jurisdictions, such as the Netherlands, have been stated to be:

“first, a unitary conception of ownership, inconsistent with duplication or division of rights *in rem* in the same thing; second, the supplementary notion, elaborated in the German doctrine, that public registration of rights *in rem* involves taxative codification

⁴⁵³ British Columbia, but only for absence on war service (Trustee Act RSBC 1996 ch 464 s 14); Manitoba (Trustee Act CCSM ch T160 s 36); New Brunswick (Trustees Act RSNB 1973 ch T-15 s 6).

⁴⁵⁴ Ontario Trustee Act RSO 1990 ch T23, s 20.

⁴⁵⁵ Cantin Cumyn in *Re-imagining the Trust* 22.

⁴⁵⁶ Civil Code of Québec SQ 1991 ch 64 art 1278.

⁴⁵⁷ Civil Code of Québec SQ 1991 ch 64 art 1332.

⁴⁵⁸ Civil Code of Québec SQ 1991 ch 64 art 1333.

⁴⁵⁹ Civil Code of Québec SQ 1991 ch 64 art 1334.

⁴⁶⁰ Civil Code of Québec SQ 1991 ch 64 art 1337.

⁴⁶¹ The new Dutch Civil Code came into force in 1992.

of such rights, a *numerus clausus*; and third, the appearance of a variety of devices, serving in a degree the same purposes as trusts and calculated for practical reasons to escape the procrustean bed prepared for the evolution of property law by the imperious logic of these conceptions.”⁴⁶²

Futhermore, the Civil Code makes it clear that trusts may not be created under Dutch law.⁴⁶³

The above quote refers to devices which serve the same purposes as a trust. In the Netherlands there are a number of devices which would fit that description. Two are briefly described here, namely the *bewind* and the *fiducia cum amico*.⁴⁶⁴

The *bewind* is a form of fiduciary administration, but it may only be used in certain limited family-related situations.⁴⁶⁵ The *bewindvoerder* manages the assets for the benefit of a beneficiary, but it is the beneficiary and not the *bewindvoerder* who is the owner of the assets.⁴⁶⁶ Thus the *bewind* differs from the trust in the sense that in a trust the trustee is the owner of the trust assets. In a *bewind* the beneficiary is protected in the case of the insolvency of the *bewindvoerder*, as the assets do not form part of the latter’s estate.⁴⁶⁷

In a *fiducia cum amico* the assets are transferred to a manager, who becomes the owner of the assets. The manager has the duty to manage and dispose of the assets for the benefit of the beneficiaries. Beneficiaries only have personal rights against the manager and are therefore exposed in the case of the managers’ insolvency.⁴⁶⁸ A nominee account⁴⁶⁹ is a special application of the *fiducia cum amico* and is explained as follows:

“If A transfers money to B’s bank account, designated to be held by B for A’s benefit, such money will not be regarded as owned by B upon B’s insolvency but is available only for A and not for B’s creditors.”⁴⁷⁰

Neither of these devices are proper trusts and they are often described as trust-like institutions.⁴⁷¹

⁴⁶² Sonneveldt in *The Trust: Bridge or Abyss between Common and Civil Law Jurisdictions?* 14, quoting Bolgár (1953) 2 *American Journal of Comparative Law* 208 210.

⁴⁶³ Civil Code art 84 s 3 of Book 3; Van Erp (2011) 15 *Edin LR* 479 479.

⁴⁶⁴ Others include the *stichting*, the mandate, the mutual fund and the security trustee (Kortmann and Verhagen in *Principles of European Trust Law* 202).

⁴⁶⁵ Koppenol-Laforce and Kottenhagen in *Netherlands Reports to the Fifteenth International Congress of Comparative Law* 143; Kortmann and Verhagen in *Principles of European Trust Law* 200.

⁴⁶⁶ De Waal in *The Oxford Handbook of Comparative Law* 1092.

⁴⁶⁷ Kortmann and Verhagen in *Principles of European Trust Law* 199.

⁴⁶⁸ Kortmann and Verhagen in *Principles of European Trust Law* 197.

⁴⁶⁹ Kortmann and Verhagen in *Principles of European Trust Law* 198. Certification is described by the same authors as another specific application of the *fiducia cum amico*.

⁴⁷⁰ Koppenol-Laforce and Kottenhagen in *Netherlands Reports to the Fifteenth International Congress of Comparative Law* 142.

⁴⁷¹ De Waal in *The Oxford Handbook of Comparative Law* 1091.

2.5.2 The Hague Convention on Trusts

The Netherlands acceded to The Hague Convention on Trusts and at the same time enacted legislation, known as the “*Wet Conflictenrecht Trust*”,⁴⁷² which came into force on 1 February 1996.

Article 11 of The Hague Convention on Trusts provides:

“A trust created in accordance with the law specified by the preceding Chapter shall be recognised as a trust.

Such recognition shall imply, as a minimum, that the trust property constitutes a separate fund, that the trustee may sue and be sued in his capacity as trustee, and that he may appear or act in this capacity before a notary or any person acting in an official capacity.

In so far as the law applicable to the trust requires or provides, such recognition shall imply, in particular –

- a) that personal creditors of the trustee shall have no recourse against the trust assets;
- b) that the trust assets shall not form part of the trustee's estate upon his insolvency or bankruptcy;
- c) that the trust assets shall not form part of the matrimonial property of the trustee or his spouse nor part of the trustee's estate upon his death;
- d) that the trust assets may be recovered when the trustee, in breach of trust, has mingled trust assets with his own property or has alienated trust assets. However, the rights and obligations of any third party holder of the assets shall remain subject to the law determined by the choice of law rules of the forum.”

In terms of article 15 of The Hague Convention on Trusts the mandatory rules of the national law (that is, Dutch law in this case) regarding, inter alia, the transfer of title to property and security interests in property and the protection of creditors in matters of insolvency, will still apply despite the Convention. In terms of Dutch law all the assets of a debtor is available to his or her creditors. Hence, trust assets owned by a trustee would be available to his or her personal creditors in terms of Dutch law and, therefore, the trust property would not be recognised as a separate fund. In order to avoid this problem, the *Wet Conflictenrecht Trust*⁴⁷³ provides that the rules of Dutch law regarding the transfer of property, security interests or protection of creditors upon insolvency do not prevent recognition of the trust in terms of article 11 of The Hague Convention on Trusts. Furthermore, the *Wet Conflictenrecht Trust* also prevents Dutch law⁴⁷⁴ from precluding the transfer of assets to a separate trust fund.⁴⁷⁵ Thus a Dutch person may be a trustee of a trust created in terms of foreign law, in respect of property situated both in and outside of the Netherlands. The

⁴⁷² *Wet Conflictenrecht Trust* Dutch Staatsblad 1995, 505 and 1996, 18.

⁴⁷³ *Wet Conflictenrecht Trust* Dutch Staatsblad 1995, 505 and 1996, 18 art 4.

⁴⁷⁴ Civil Code art 84(3) of Book 3.

⁴⁷⁵ Koppenol-Laforce and Kottenhagen in *Netherlands Reports to the Fifteenth International Congress of Comparative Law* 144; Hayton in *Vertrouwd met de Trust: Trust and Trust-like Arrangements* 58; Hayton (1997) 128 *WPNR* 542 543; Verhagen in *Vertrouwd met de Trust: Trust and Trust-like Arrangements* 89.

property may be transferred to him or her and will constitute a separate fund from his or her personal patrimony.⁴⁷⁶

There are numerous issues regarding the recognition of trusts which have not yet been settled yet in terms of Dutch law. Examples of these are: whether in respect of property situated in the Netherlands, the trust must be entered in (public) registers;⁴⁷⁷ how creditors dealing with trustees must be treated in the light of article 11 of The Hague Convention on Trusts;⁴⁷⁸ and what happens to trust assets when a trustee dies.⁴⁷⁹ Most writers agree that these issues would be best addressed by way of legislation.⁴⁸⁰

2.6 OECD MTC

The OECD MTC and its Commentary make no mention of trusts.⁴⁸¹

Article 3(2) of the OECD MTC provides:

“As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at the time under the laws of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that state.”

Since the term “trust” is not defined in the OECD MTC, countries may be tempted, in interpreting article 3(2), to apply their domestic law definition of what a trust is. However, the domestic law meaning of a term can only be applied by virtue of article 3(2) if the term is used somewhere in the treaty.⁴⁸² Since the term trust is not used anywhere in the OECD MTC, article 3(2) cannot be applied. Whether and how the OECD MTC is to be applied to trusts will be discussed in the further chapters of this research.

2.7 Conclusion

The history of each of the jurisdictions discussed above is unique, as may be expected. No doubt the English trust preceded the trusts in all the other jurisdictions and in a sense all of these jurisdictions were influenced by English trust law. However, the extent of the influence differs greatly: in Canada the influence of English trust law is the greatest, since the largest

⁴⁷⁶Koppenol-Laforce and Kottenhagen in *Netherlands Reports to the Fifteenth International Congress of Comparative Law* 145; Hayton in *Vertrouwd met de Trust: Trust and Trust-like Arrangements* 58.

⁴⁷⁷ Koppenol-Laforce and Kottenhagen in *Netherlands Reports to the Fifteenth International Congress of Comparative Law* 146.

⁴⁷⁸ Hayton in *Vertrouwd met de Trust: Trust and Trust-like Arrangements* 62.

⁴⁷⁹ Hayton in *Vertrouwd met de Trust: Trust and Trust-like Arrangements* 63.

⁴⁸⁰ Hayton in *Vertrouwd met de Trust: Trust and Trust-like Arrangements* 64; Koppenol-Laforce and Kottenhagen in *Netherlands Reports to the Fifteenth International Congress of Comparative Law* 152; Hayton (1997) 128 *WPNR* 542 545.

⁴⁸¹ The only references to trusts in the OECD MTC and the Commentary are found in reservations by member countries. Eg, the United Kingdom mentions trusts in its reservation to art 21 (para 15 of the commentary to art 21) and Australia and New Zealand refer to trusts in their reservation to art 7 (para 76 of the commentary to art 7).

⁴⁸² Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 3C.11; OECD Commentary on art 3(2), para 11.

part of Canada adopted English law as its own and by the time of such adoption, the trust had been a well-developed entity. An exception to this is the province of Québec. Although the English trust was used very early in Québec, legislation was soon introduced to govern the law of trusts in this province where the law of property is based on civilian principles. Thus Québec trust law is governed by statute and has developed separately from trust law in the rest of Canada. South Africa, similarly, initially adopted the English law trust, but the courts subsequently developed its own trust law, creating a unique South African entity. Legislation played virtually no role in this development. Although there are many similarities between South African and Scottish trust law, their histories could not be more different. Although the origin of Scottish trust law is anything but certain, it is clear that the English trust did not form the basis of the Scottish trust. However, English trust law did influence the already existing Scottish trust during a later phase. The Netherlands does not have a proper trust as part of its law, but as a signatory to The Hague Convention on Trusts is obliged to recognise trusts formed in terms of the laws of other jurisdictions.

Unsurprisingly, jurisdictions differ in the way in which they define a trust. Some countries, like South Africa, have a statutory definition, although this definition is not exhaustive. The Civil Code of Québec does not contain an actual definition of a trust, but more a description of a trust. In England, Scotland and the rest of Canada, The Hague Convention on Trusts is applicable and therefore the definition in that Convention is a common denominator, but in each of those jurisdictions no other statutory definition, which could serve as a comprehensive definition, was found. In these jurisdictions a description of the trust's main features, rather than a definition, seems to be preferred. It is submitted that the only definition which could be relevant for the Netherlands is the one contained in The Hague Convention on Trusts. South Africa is the only jurisdiction which specifically defines a trust for income tax purposes. In other jurisdictions the term remains undefined in the relevant income tax legislation, which leads to the conclusion that trust law must be applied to determine whether an entity is a trust for income tax purposes.

Regarding the ownership of trust assets, it is axiomatic that in all the jurisdictions discussed above (except Québec) the trustees are the owners of the trust assets. In England and the rest of Canada the concept of dual ownership exists and trustees have the "legal ownership" over the trust property. Beneficiaries in fixed trusts have "equitable ownership" or "beneficial ownership". Describing the interests of beneficiaries in a discretionary trust as proprietary is more problematic. Authors therefore suggest that discretionary beneficiaries' interest be described as a proprietary interest in the wider sense or "*quasi-property interest*". In South Africa and Scotland, the concept of dual ownership does not form part of the law. Beneficiaries in both these jurisdictions therefore have only personal rights against the trustees and no form of ownership. In Québec, the concept of dual ownership is also foreign. The relevant legislation provides that the property transferred in trust constitutes a patrimony by appropriation, distinct from the settlor, the beneficiary or the trustee. Opinions seem to differ on whether the trust assets are owned by the trust itself or by no-one, but the legislation is explicit that the trustees and the beneficiaries have no ownership rights in the trust assets.

In South Africa, England, Scotland and the rest of Canada, the trust assets form a separate estate (also called a fund or a patrimony) in the hands of the trustees and are immune to the trustees' personal creditors. Trustees are also under a duty to keep trust assets separate

from their own assets. In Québec the beneficiaries' claims are settled from the trust patrimony and not from the trustees' personal patrimonies.

In none of the above jurisdictions is the trust regarded as a juristic person. In South Africa, Scotland and Québec it is, however, acknowledged that the trust is treated as a juristic person under certain circumstances. For South African income tax and Canadian federal income tax purposes, the trust is regarded as a taxable entity. In the United Kingdom, the trustees are regarded as a single person for income tax purposes, distinct from the persons who are the trustees from time to time.

In all of the jurisdictions referred to above trusteeship is regarded as an office. Although this element is more pertinent in terms of South African law, the courts in all the other jurisdictions exert control over trusts in some way or another, reflecting the concept of trusteeship as an office.⁴⁸³ In all of the jurisdictions, the trustees owe certain fiduciary duties to the beneficiaries.

In none of the jurisdictions is a trust equated to agency and it is specifically stated in the law of South Africa, England, Scotland and the rest of Canada that a trustee is not an agent of either the settlor or the beneficiary. The Civil Code of Québec is silent on whether the trustees are the agents of the beneficiaries or the settlor, but if the nature of the trust (being an autonomous patrimony in which the settlor, beneficiary or trustee has no real right) is considered, it is submitted that the trustee cannot be the agent for either the settlor or the beneficiary.

Both *inter vivos* and testamentary trusts are found in all of the above jurisdictions. Similarly, all of the jurisdictions distinguish between vesting (or fixed) trusts and discretionary trusts. The exception is Québec where the Civil Code is silent on this issue. Business trusts are found in all of the jurisdictions, barring Scotland, where trusts are not usually used for business purposes.

Regarding the requirements for a valid trust, all jurisdictions determine that *inter vivos* trusts may be created orally or in writing and that no specific technical words are required in order to create such a trust. Registration is also not a requirement for a valid *inter vivos* trust. However, in England, Scotland and some of the Canadian provinces, a trust for certain types of property, for example, land, must be in writing. In Québec, if a trust is constituted by way of a gift, the formal requirements for the gift must be met and in the case of a business trust, where an onerous contract is involved, the rules applicable to contracts must be met. In the case of a testamentary trust, all countries require a valid will as a precondition for the formation of a valid trust.

In England, Scotland, the rest of Canada and Québec, two elements must usually be present in order to create a valid trust, namely, there must be a declaration of trust and the trust assets must be transferred to the trustees. In Québec an additional requirement is that the trustee must accept the trust property. In South Africa, this two-step process is not required. Once the requirements for a valid trust have all been met, the trust will be formed. One of these requirements is unique to South Africa, namely that the settlor's intention must be expressed in a mode appropriate to create an obligation. In other words, as long as there is,

⁴⁸³ De Waal (2001) 12 *Stell LR* 63 81; De Waal (2000) 117 *SALJ* 548 566.

for example, a lawful obligation on the settlor to transfer the assets (even though actual transfer has not taken place), the trust will be validly created.

In England and the rest of Canada it is possible for a settlor to declare himself or herself trustee of his or her property and in such a case there is no need to transfer property. In Scotland, it is possible for a settlor to be the sole trustee of a trust, but the exact requirements for this type of trust are uncertain. In Québec, it seems impossible for a settlor to declare himself or herself as trustee of his or her patrimony.⁴⁸⁴ Similarly, in South Africa, it is impossible to declare oneself a trustee of one's own property.⁴⁸⁵

In South Africa, England and the rest of Canada, one of the express requirements for a valid trust is that the settlor must have an intention to create a trust. Although none of the text books spell out this requirement for Scotland, it is submitted that the intention to create a trust is a requirement, as the settlor must declare a trust. Surely a settlor cannot declare a trust if he does not have the required intention. In Québec, leaving aside trusts created by statute or judicial order, a trust may be created by will or by a contract. Both of the latter ways of creating a trust involve the expression of an intention and it has been held that a settlor who retains significant control over the trust assets does not have the intention to create a valid trust. Hence it can be deduced that the intention to create a valid trust is also a requirement in Québec.

Three requirements are common to South Africa, England, Scotland and the rest of Canada, namely certainty of trust property, certainty of the trust object and that the trust object must be lawful. The Civil Code of Québec is silent on these requirements.

The law of England, Scotland and the rest of Canada contain rules against perpetuity and accumulation. In Québec the rule limiting the duration of the trust only applies to personal trusts.⁴⁸⁶ No such rules are to be found in South Africa.

The beneficiary principle, meaning that the trust must be for the benefit of a person, not a purpose (unless charitable), is applicable only in England and the rest of Canada. In South Africa, Scotland and Québec it is possible to create a trust for a purpose which is not charitable.

Administrative workability is a further requirement in England. The other jurisdictions under discussion do not have a similar requirement.

In all of the relevant jurisdictions, the administration of the trust is in the hands of the trustees. Two aspects of trust administration must be distinguished, namely the requirement of joint action and that of delegation.

Regarding the first element, trustees in South Africa must, in principle, act jointly, although the trust deed may allow decisions to be made otherwise, for example by majority decision. In England, trustees must act jointly, unless otherwise authorised by the trust instrument. In Scotland the trust deed may lay down rules for the conduct of the trust's affairs, but in the

⁴⁸⁴ Waters *Waters' Law of Trusts in Canada* ch 28.III 3; Cantin Cumyn in *Trusts in Mixed Legal Systems* 76.

⁴⁸⁵ Cameron *et al Honoré's South African Law of Trusts* 144.

⁴⁸⁶ Civil Code of Québec SQ 1991 ch 64 arts 1271 to 1273.

absence of such rules, the trustees may make decisions by majority vote. This rule is subject to the qualification that all trustees must be consulted. However, a failure to consult any trustee will not result in a deed entered into by the trustees with a third party, who dealt onerously and in good faith, being void. Third parties are thus protected. In Canada, trustees must act jointly, unless the trust instrument provides otherwise. In Québec decisions may be taken by majority vote, unless trustees are required by law to act jointly. Under certain circumstances fewer than the majority may also act.

Therefore, in South Africa, England and the rest of Canada, trustees must in principle act jointly, unless the trust instrument provides otherwise. In Scotland and Québec a majority is sufficient to take a decision.

Regarding the second element, namely delegation, South African trustees may delegate their administrative functions to others, but remain responsible to supervise the actions of the person to whom they have delegated. Fundamental decisions must be taken by the trustees, though. Although a grey area may arise regarding the distinction between administrative functions and fundamental decisions, the principle is clear enough. In England, every trustee must act personally, although the trustees may (collectively) delegate some of their functions, as specified in the relevant legislation, to an agent. The trustees' ability to delegate their functions may be curtailed in the trust deed. Trustees also have duties of supervision in relation to an agent. In terms of legislation (or if allowed in terms of the trust deed), an individual trustee may also delegate the execution or exercise of his or her powers or discretions. In Scotland trustees may, in terms of legislation, appoint law agents and factors unless prohibited by the trust deed. In terms of Canadian law, trustees may delegate their functions under certain circumstances. The test laid down by Waters regarding the circumstances under which delegation may take place (namely that policy decisions must be made by trustees themselves) corresponds closely to the position in South Africa (where fundamental decisions must be taken by the trustees). Similarly, in both countries trustees may never delegate all of their functions, as it would amount to an abdication of responsibility. Legislation in some Canadian provinces allows the trustees to employ certain agents. In Québec a trustee may delegate his or her duties or be represented by a third person for specific acts, but may not delegate generally the conduct of the administration or the exercise of a discretionary power, except to his or her co-trustees.

Therefore, in South Africa, England and the rest of Canada the trustees may delegate some of their lesser functions, but not the more important ones. In Québec delegation of general administration or exercise of a discretionary power may take place, but only to co-trustees. In Scotland an agent may be appointed, either in terms of statute or common law, if a person of reasonable prudence dealing with his or her own affairs would consider such employment appropriate.

To conclude, there are remarkable similarities in the laws of the jurisdictions referred to above, especially regarding the lack of juristic personality, some of the requirements for the formation of the trust and some aspects of the administration of trusts. Considering the history of each jurisdiction and the separate paths of development in each jurisdiction, these similarities are somewhat surprising, but nevertheless significant. Other aspects, such as the nature of beneficiaries' interests, differ greatly and can be traced back to the specific property law regime applicable in each jurisdiction.

CHAPTER 3

THE TAXATION OF TRUSTS

Chapter overview	60
3.1 Introduction	62
3.2 South Africa	64
3.2.1 Introduction	64
3.2.2 The taxation of trusts and beneficiaries	65
3.2.3 Income retains its nature	68
3.2.4 Income deemed to be that of another	70
3.2.5 Conclusion	74
3.3 United Kingdom	74
3.3.1 Introduction	74
3.3.2 Discretionary trusts	74
3.3.2.1 Taxation of the trustee of a discretionary trust	75
3.3.2.1.1 Charge on the trustee on receipt of income	75
3.3.2.1.2 Charge on the trustee on making a discretionary payment of income	75
3.3.2.2 Taxation of the beneficiary	76
3.3.2.2.1 Charge on the beneficiary on receiving a discretionary payment of income	76
3.3.2.2.2 Discretionary trust treated as transparent	77
3.3.3 Fixed trust	78
3.3.3.1 Taxation of the trustee	78
3.3.3.2 Taxation of the beneficiary	78
3.3.4 Settlor-interested trusts	79
3.3.5 Payments to minor unmarried children of the settlor	80
3.3.6 Transfer of assets abroad	81
3.3.7 Conclusion	81
3.4 Canada	82
3.4.1 Introduction	82
3.4.2 The taxation of trusts	82
3.4.3 The taxation of beneficiaries	83

3.4.4	Flow-through character of income	84
3.4.5	Income taxed in the hands of the settlor	85
3.4.6	Non-resident trusts and non-resident beneficiaries	86
3.4.7	Conclusion	88
3.5	The Netherlands	88
3.5.1	Introduction	88
3.5.2	<i>Afgezonderd particulier vermogen</i>	89
3.5.3	The APV legislation is not applicable	90
3.5.4	Conclusion	92
3.6	Conclusion	92

3.1 Introduction

The aim of this chapter is to provide an overview of the taxation of trusts in each of the states under consideration. Such an overview will provide a vital backdrop for the discussion of the application of the provisions of the Organisation for Economic Co-operation and Development Model Tax Convention (OECD MTC) to trusts in later chapters. More specifically, the way in which each state chooses to tax a trust (or trustee) and the other parties involved in the trust relationship, influences the manner in which the OECD MTC is applied in respect of the trust, the trustee or the other parties. For example, treating a trust as a taxable entity in terms of domestic tax law, will impact significantly on whether the trust should be regarded as a person or a resident for purposes of the OECD MTC. Furthermore, it is trite that each state levies taxes in accordance with its own law. Therefore, as an exercise of its sovereign power, each state decides how, when and to what extent it will tax the parties involved in a trust relationship. Double Taxation Treaties (DTTs) are then applied to limit the application of the contracting states' own laws, in order to avoid double taxation.⁴⁸⁷ Thus, an investigation of each state's tax laws is required to establish the way in and extent to which that particular state taxes trusts. The treaty will then determine whether those laws are to be limited. Vogel explains this point as follows: "[T]he treaty acts like a stencil that is placed over the pattern of domestic law and covers over certain parts. Whether the stencil or the pattern is examined first, the same conclusion results ..."⁴⁸⁸

According to Wheeler, many common law states (which include the United Kingdom and Canada) follow the same broad policy aim in the taxation of trusts, namely that income passing through the trust is taxed only once. She adds, however, that the mechanisms used to achieve this aim differ significantly.⁴⁸⁹ It may be deduced from the systems used by South Africa and the Netherlands respectively that these states subscribe to the same policy aim. However, as will become apparent from the discussion in this chapter, each of the states discussed in this dissertation uses a different mechanism to achieve this aim.

There is more than one way to classify the systems used by various states. One classification focuses on the mechanism used, while the other focuses on the person that is to be taxed. Under the first classification, three systems are identified, namely (a) the initial choice system; (b) the credit system; and (c) the deduction system.

In the initial choice system a choice, whether to tax the beneficiary or the trust, is made as trust income arises. Thus, generally speaking, if a beneficiary is entitled to the trust income, or it is distributed to the beneficiary within the tax year, it is taxed in the hands of the beneficiary. If, however, no beneficiary is entitled to the income, the trust will be liable to tax on the income (a typical example being retained income). When the income is eventually distributed to the beneficiary, no tax is imposed on either the trust or the beneficiary.

⁴⁸⁷ Vogel *et al* Klaus Vogel on Double Taxation Conventions 20 and 26.

⁴⁸⁸ Vogel *et al* Klaus Vogel on Double Taxation Conventions 31. There is a debate over whether domestic tax law or the treaty should be applied first. However, a discussion of this debate falls outside the scope of this dissertation.

⁴⁸⁹ Wheeler (2011) 3 *World Tax Journal* 247 345.

Australia and New Zealand are examples of states that mainly use this system.⁴⁹⁰ As will become clear from the discussion in this chapter, South Africa also uses mainly the initial choice system.

In the credit system both the trustee and the beneficiaries are taxed: the trustee on the trust income and the beneficiaries on the distribution. However, the beneficiaries are granted a credit for the tax paid by the trustee. This is the general system followed in the United Kingdom and Ireland, although there are notable exceptions. In the deduction system both the trust and beneficiaries are again taxed, but this time the trust is allowed a deduction for the distribution made to the beneficiary. Generally, Canada and the United States of America follow the deduction system.⁴⁹¹

A different way of classifying systems of taxing trusts would be to focus on the person being taxed. Thus, (i) some states tax trusts based on the residency of the settlor; (ii) some states tax trusts based on the residency of the trustee; and (iii) some states focus on taxing the beneficiaries.

The policy behind taxing trusts based on the residency of the settlor (item (i)) is that there is a perception that the settlor, having transferred the biggest part of the trust assets to the trust, will have substantial control over the assets and, furthermore, that the state in which the settlor resides should have the economic basis for taxing the trust, where the trust is established in a low-tax state. Under this system, the trust income is either attributed to the settlor personally, or the trustee is held liable for the tax on the trust income, based on the settlor's residence. New Zealand is identified as a state that uses this system.⁴⁹² The United States of America's "grantor trust" regime is also regarded as a system where taxation is based on the residence of the settlor.⁴⁹³ From the discussion below, it will become apparent that the Netherlands follows this system as well.

In the case of states which tax trusts based on the residence of the trustee (or trust) (item (ii)) the focus is placed on the person(s) who is legally the owner(s) of the trust property. The United Kingdom is regarded as an example of such a state⁴⁹⁴ and Canada and South Africa may be added to this list. Some states tax trusts based on the fact that the beneficiaries are resident in that state (item (iii)). Under this system beneficiaries may be taxed either when they receive the trust income, or the income may be imputed to them, regardless of whether it was distributed to them or not.

⁴⁹⁰ Wheeler (2011) 3 *World Tax Journal* 247 347; Wheeler in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 37; Koele in *The Trust: Bridge or Abyss between Common and Civil Law Jurisdictions* 85–87.

⁴⁹¹ Wheeler (2011) 3 *World Tax Journal* 247 347–349; Wheeler in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 37; Koele in *The Trust: Bridge or Abyss between Common and Civil Law Jurisdictions* 85–87.

⁴⁹² Hart in *Trusts and International Tax Treaties* 55.

⁴⁹³ Hart in *Trusts and International Tax Treaties* 60. Hart describes a grantor trust as one in which the settlor retains certain rights, benefits and powers and where, on a federal level, the settlor is taxed as if he or she still owns the trust assets.

⁴⁹⁴ Hart in *Trusts and International Tax Treaties* 62.

Interestingly, authors concede that many states adopt a combination of these systems.⁴⁹⁵ For example, in South Africa some anti-avoidance provisions will ensure that certain income is taxed in the hands of the settlor (item (i)). The trust is regarded as a person and taxed in South Africa if it is resident there on all undistributed income (item (ii)) and the beneficiaries of a trust are taxed if they have a vested right to the income (item (iii)). As stated above, South Africa may also be classified as following an initial choice system (item (a)).

The way in which each of the states under discussion in this dissertation taxes trusts is addressed in the remainder of this chapter.

3.2 South Africa

3.2.1 Introduction

The Income Tax Act⁴⁹⁶ defines the term “trust” as:

“any trust fund consisting of cash or other assets which are administered and controlled by a person acting in a fiduciary capacity, where such person is appointed under a deed of trust or by agreement or under the will of a deceased person.”⁴⁹⁷

Once an entity is brought within the ambit of this definition, it will be regarded as a person for purposes of the Income Tax Act⁴⁹⁸ and will, consequently, be liable to tax in terms of that Act.⁴⁹⁹ Thus, it is the trust itself that is (potentially) a taxpayer, with the trustee(s) being the representative taxpayer of the trust.⁵⁰⁰ Like all other taxpayers, trusts that are resident in South Africa are taxed, generally speaking, on their worldwide receipts and accruals, while trusts that are non-residents are taxed, generally speaking, only on income from South African sources.⁵⁰¹ Trusts (other than “special trusts”⁵⁰² and trusts that fall under a specific

⁴⁹⁵ Cadesky in *Trusts and International Tax Treaties* 9; Thuronyi and Easson in *Tax Law Design and Drafting* 27. Hart mentions the example of Australia that uses all three systems (items (i) to (iii)) (Hart in *Trusts and International Tax Treaties* 66). Other examples may also be given: The United Kingdom, classified above under items (b) and (ii), also taxes the beneficiary directly if the beneficiary is entitled to the income as it arises and it is paid directly to the beneficiary (Wheeler (2011) 3 *World Tax Journal* 247 347), placing it firmly within items (a) and (iii) respectively. In the United Kingdom and Canada, certain anti-avoidance provisions also attribute the trust income to the settlor under certain circumstances, which would result in these states falling under item (i) as well.

⁴⁹⁶ Income Tax Act 58 of 1962 s 1.

⁴⁹⁷ For a discussion of this definition see ch 2.2.3.

⁴⁹⁸ Income Tax Act 58 of 1962 s 1 definition of “person”. The term trust was defined and a “trust” was included in the definition of “person” directly as a result of *Commissioner for Inland Revenue v Friedman and Others* NNO 1993 1 SA 353 (A). In that case the court held that a trust was not a person and could therefore not be liable to tax and, consequently, the trustee could not act (and be taxed) as the representative taxpayer of the trust. See further ch 5.2.2 and 5.4.

⁴⁹⁹ Income Tax Act 58 of 1962 s 5(1)(c).

⁵⁰⁰ Income Tax Act 58 of 1962 s 1, definition of “taxpayer” and “representative taxpayer”, read with Tax Administration Act 28 of 2011 s 1 definition of “representative taxpayer”. For a discussion of the trust as a taxpayer and the role of the trustee as representative taxpayer, see ch 6.2.2.2.

⁵⁰¹ Income Tax Act 58 of 1962 s 1 definition of “gross income”. How the residence of a trust is determined for South African income tax purposes is discussed in ch 6.3.1.

⁵⁰² It is reiterated here that “special trusts” fall outside the scope of this dissertation. A special trust is defined in Income Tax Act 58 of 1962 s 1.

tax regime⁵⁰³) are taxed at a flat rate of 40%. Similarly, beneficiaries that are resident in South Africa will be taxed on their worldwide receipts and accruals, whilst non-resident beneficiaries will be liable to tax only on their receipts and accruals from a South African source.⁵⁰⁴ Thus, a South African resident beneficiary may, for example, be liable to tax on amounts distributed to it from a non-resident trust. Furthermore, a South African resident beneficiary may also be liable to tax on the distribution of a dividend from foreign shares owned by a South African resident trust.

There are at least three persons who could potentially be liable for income derived by the trust, namely (a) the trust itself; (b) the beneficiaries; or (c) the person to whom income is deemed to have accrued.⁵⁰⁵ These possibilities are discussed below with reference to the applicable legislation.

3.2.2 The taxation of trusts and beneficiaries

Section 25B provides, *inter alia*, that:

“Any amount received by or accrued to or in favour of any person during any year of assessment in his or her capacity as the trustee of a trust, shall, subject to the provisions of section 7, to the extent to which that amount has been derived for the immediate or future benefit of any ascertained beneficiary who has a vested right to that amount during that year, be deemed to be an amount which has accrued to that beneficiary, and to the extent to which that amount is not so derived, be deemed to be an amount which has accrued to that trust.”⁵⁰⁶

The effect of this provision is that:

- (a) An amount that is received by or accrues to a trust, is deemed to have accrued to a beneficiary,⁵⁰⁷ if that beneficiary is ascertained, has a vested right to the income and the amount has been derived for the benefit of that beneficiary. In such a case, the beneficiary is liable to tax on the relevant amount and the trust is not taxed on that amount at all.
- (b) An amount that is received by or accrues to a trust is taxed in the hands of the trust if there is no ascertained beneficiary, for whose benefit the amount was derived, with a vested right to that income. In such a case, only the trust will be taxed and not the beneficiary.

⁵⁰³ Eg, the regime for “personal service providers” or collective investment vehicles. As stated earlier, these special regimes fall outside the scope of this dissertation.

⁵⁰⁴ Income Tax Act 58 of 1962 s 1 definition of “gross income”. See ch 3.2.3 regarding the source of a non-resident beneficiary’s income.

⁵⁰⁵ A fourth possibility exists, namely that the trustee (as representative taxpayer) may be held personally liable for taxes due by the trust. However, this possibility will only arise if the taxes are in arrears and the trustee takes certain further actions (Tax Administration Act 28 of 2011 s 155). For a discussion of this and other provisions regarding the liability of trustee, see ch 6.2.2.2.

⁵⁰⁶ Income Tax Act 58 of 1962 s 25B(1).

⁵⁰⁷ The Income Tax Act defines a beneficiary as “a person who has a vested or contingent interest in all or a portion of the receipts or accruals or the assets of that trust” (Income Tax Act 58 of 1962 s 1 definition of “beneficiary”). Clearly, both vested and discretionary beneficiaries are covered by the definition. Furthermore, it is irrelevant whether the person is a South African resident or not.

In the case of a discretionary trust, the exercise by the trustee of his or her discretion in favour of the beneficiary will result in the beneficiary acquiring a vested right to an amount received by or accrued to a trustee during that year of assessment.⁵⁰⁸ Therefore, if the trustee of a discretionary trust exercises his or her discretion in favour of a beneficiary during a particular year of assessment, the beneficiary will be regarded as having a vested right to the relevant income and will, consequently, be taxed on that income. The trust will, therefore, not be liable to tax in respect of the income distributed to such a beneficiary.

It should further be noted that it is the vesting of the amount in the hands of the beneficiary that results in its accrual to the beneficiary.⁵⁰⁹ An amount is vested in a beneficiary because of the terms of the trust deed (in the case of a vesting trust), or because of the exercise by the trustee of his or her discretion (in the case of a discretionary trust), typically by taking a resolution to distribute an amount to a specific beneficiary. Often, the exercise of the discretion (that is, vesting) will take place at the same time as (or just before) payment to the beneficiary. Payment of the amount to the beneficiary may, however, be delayed and in these circumstances the beneficiary will be regarded as having a vested right to the amount, even though it has not been paid to him or her.⁵¹⁰

The section further regulates who may claim the allowable deductions associated with the relevant trust income. Its effect is that deductions are allocated between the trust and the beneficiaries in the same proportion as the income that has been allocated in terms of the section.⁵¹¹ Thus, to the extent to which the income is deemed to have accrued to a beneficiary, the beneficiary must claim the deduction and to the extent to which the income is deemed to have accrued to the trust, the trust must claim the deduction.⁵¹² However, the deduction that a beneficiary is allowed to claim is limited to the amount deemed to have accrued to the beneficiary from that trust during the year of assessment.⁵¹³ Any excess may be deducted by the trust, but, again, the deduction is limited to the taxable income of the trust in that year of assessment.⁵¹⁴ Any excess to this deduction is deemed to be a deduction that the beneficiary may claim during the immediately succeeding year of assessment against an amount accrued to him or her from the trust.⁵¹⁵

Importantly, though, the provisions of section 25B are made subject to section 7. The provisions of section 7 are discussed below, but its effect on the application of section 25 is crucial. This is summed up by De Koker and Williams as follows:

⁵⁰⁸ Income Tax Act 58 of 1962 s 25B(2). For a discussion regarding the meaning of “vested right” and “discretionary right” see ch 2.2.4.

⁵⁰⁹ De Koker and Williams *Silke on South African Income Tax* para 12.14C.

⁵¹⁰ De Koker and Williams *Silke on South African Income Tax* para 12.14C; Davis *et al Estate Planning* para 6.2; Davis *et al Juta's Commentary on Income Tax* Commentary on s 25B(1). See also ch 2.2.4.

⁵¹¹ De Koker and Williams *Silke on South African Income Tax* para 12.14C.

⁵¹² Income Tax Act 58 of 1962 s 25B(3).

⁵¹³ Income Tax Act 58 of 1962 s 25B(4).

⁵¹⁴ Income Tax Act 58 of 1962 s 25B(5)(a). However, in the case of a trust not subject to tax in South Africa, the excess must be carried forward and will be deemed to be a deduction which may be made by that beneficiary during the immediately succeeding year of assessment (Income Tax Act 58 of 1962 s 25B(5)(b)).

⁵¹⁵ Income Tax Act 58 of 1962 s 25B(6). However, none of the provisions regarding the excess (that is, s 25B(4) to (6)) is applicable if the beneficiary is not subject to tax in South Africa on the amount accrued to him or her from the trust (Income Tax Act 58 of 1962 s 25B(7)).

“The result is that income deemed to have been derived by someone, for example, a spouse or parent, under s 7 will remain where it has been made to lie and cannot be deemed to have been derived by a trust or its beneficiaries under s 25B. Section 25B therefore comes into operation only to the extent that s 7 does not already apply.”⁵¹⁶

In an international context, a further provision of section 25B should be borne in mind. It deals with distributions from non-resident trusts and aims to combat the accumulation of income in a trust (which is not from a South African source and therefore not taxed in South Africa) and the subsequent distribution thereof as capital, thus avoiding the payment of income tax in South Africa.⁵¹⁷ It provides that if any resident acquires any vested right in the year of assessment to any amount representing capital of any non-resident trust, that amount must be included in the income of that resident in that year, if (a) that capital arose from any receipts and accruals of such trust which would have constituted income if such trust had been a resident, in any previous year of assessment during which that resident had a contingent right to that amount; and (b) that amount has not been subject to tax in South Africa in terms of the Income Tax Act.⁵¹⁸

De Koker and Williams explain the section by way of the following example:

“It follows that if a resident beneficiary had a contingent right to the income of a non-resident discretionary trust for, say, ten years during which income is accumulated in the trust, and he acquires a vested right to that income in a subsequent year, he will be liable to tax on the accumulated income accruing in that subsequent year.”⁵¹⁹

The section will not apply if:

- (a) The beneficiary did not have a contingent right when the income accrued to the trust.⁵²⁰ For example, if income accrued to the trust in year one, but a certain beneficiary only became a beneficiary in year three and the capital is distributed in year four, the section cannot be applied to that beneficiary.⁵²¹

⁵¹⁶ De Koker and Williams *Silke on South African Income Tax* para 12.14C. Davis *et al* are of the view that the provisions of s 25B(2) (which deal with the exercise by the trustee of his or her discretion), have not been made subject to s 7 (Davis *et al* *Juta's Commentary on Income Tax* Commentary on s 25B(2)). However, this argument cannot be accepted as the word “amount” in s 25B(2) clearly refers back to the word “amount” in s 25B(1) and it is clear that the accrual of that amount is subject to s 7.

⁵¹⁷ Jooste (2002) *Acta Juridica* 186 201; Davis *et al* *Estate Planning* para 6.3.1. See also the discussion of this section in Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 343–350. S 25B(2A) could possibly apply to attribute the income to the settlor, in circumstances in which the settlor is also a beneficiary, provided that none of the provisions of s 7 apply. Under these circumstances, the provisions of s25B(2A) should also be considered for purposes of para 3.2.4.

⁵¹⁸ Income Tax Act 58 of 1962 s 25(2A).

⁵¹⁹ De Koker and Williams *Silke on South African Income Tax* para 12.15C.

⁵²⁰ Jooste (2002) *Acta Juridica* 186 202; Davis *et al* *Estate Planning* para 6.3.1.

⁵²¹ See Davis *et al* *Juta's Commentary on Income Tax* Commentary on s 25B(2A) for further practical difficulties caused by the words “contingent right”.

- (b) The beneficiary is not a resident at the time that he or she acquires a vested right to the capital, even if he or she was a resident while he or she had a contingent right to the income.⁵²²
- (c) The “genuine” capital of the trust is being distributed,⁵²³ that is, capital that did not arise as a consequence of a capitalisation of income.⁵²⁴
- (d) The income has already been subject to tax in South Africa.⁵²⁵
- (e) The receipts and accruals of the trust did not constitute “income”.⁵²⁶

3.2.3 Income retains its nature

A common law principle that is still relevant, even if section 25B is applied, is the “conduit pipe” principle. In terms of this principle, income accruing to a trust retains its nature until it reaches the beneficiaries in whose hands it will be taxed. The trust is therefore a mere “conduit pipe” through which income flows.⁵²⁷ In the case of *Rosen*, the court made the following statement:

“It suffices to say that the trust deed may itself entitle or oblige the trustee to administer the dividends in such a way that he is not a mere conduit-pipe for passing them on to the beneficiary, that in his hands their source as dividends can no longer be identified or they otherwise lose their character and identity as dividends, and that the beneficiary is thus entitled to receive mere trust income in contradistinction to the benefit of the dividend rights in terms of the above crucial phrase. Thus, a trust deed may endow the trustee with a discretion to pass on dividends to the beneficiary or to retain and accumulate them. If he decides on the latter, I think (but express no firm view) that the dividends might then lose their identity and character as dividends, so that, if they are subsequently paid out to the beneficiary, they might possibly no longer be dividends in his hands, for the conduit-pipe had turned itself off at the relevant time. But if he decides on the former, i.e. to pass the dividends on to the beneficiary, the condition suspending the beneficiary’s entitlement thereto is fulfilled, and they would constitute dividends in his hands in the same way as if he had been originally

⁵²² De Koker and Williams *Silke on South African Income Tax* para 12.15C.

⁵²³ Jooste (2002) *Acta Juridica* 186 202; Davis *et al Estate Planning* para 6.3.1. Jooste provides further practical guidance to ensure that this section is not applied to “genuine” capital. He also provides a possible way in which the application of the section can be avoided altogether (Jooste (2002) *Acta Juridica* 186 204).

⁵²⁴ Davis *et al* point out the difficulties in applying the “arose from” criteria, stating that the interpretation of the phrase is likely to be very difficult in practice (Davis *et al Juta’s Commentary on Income Tax* Commentary on s 25B(2A)).

⁵²⁵ Income Tax Act 58 of 1962 s 25B(2A)(b). Academic authors cite the example of income being subject to tax in terms of s 7(5) or s 7(8) (Jooste (2002) *Acta Juridica* 186 201–202; De Koker and Williams *Silke on South African Income Tax* para 12.15C; Davis *et al Estate Planning* para 6.3.1). To this may be added the example of income that is from a South African source and therefore subject to tax in South Africa (Jooste (2002) *Acta Juridica* 186 201, Davis *et al Estate Planning* para 6.3.1), but see De Koker and Williams *Silke on South African Income Tax* par 12.15C for a contrary view.

⁵²⁶ “Income” is defined in s 1 of the Income Tax Act 58 of 1962 and excludes exempt income. Thus, eg, exempt dividends will not constitute “income”.

⁵²⁷ *Armstrong v Commissioner for Inland Revenue* 1938 AD 343; 10 SATC 1. See also De Koker and Williams *Silke on South African Income Tax* para 12.16 and Davis *et al Estate Planning* para 6.2.

entitled to them unconditionally under the trust deed, i.e. as if the conduit pipe had always been open.”⁵²⁸

Therefore, in the case of a vesting trust, the beneficiary will be taxed on the income in terms of section 25B, but the income will retain its nature. In the case of a discretionary trust, where the trustee exercises his or her discretion in favour of a beneficiary and resolves to distribute income to a beneficiary, the income will be taxed in the hands of the beneficiary in terms of section 25B, but the income will retain its nature. If, however, the trustee of a discretionary trust decides not to distribute any income to beneficiaries, the income will be taxed in the hands of the trustee and, when distributed to the beneficiaries in a subsequent year of assessment, will not be subject to income tax in their hands and might lose its character.⁵²⁹

A non-resident beneficiary will only be liable to tax on income from a South African source. Since income retains its nature when it is distributed to a beneficiary with a vested right,⁵³⁰ the rules regarding the source of income will be applied to the specific item of income distributed to the beneficiary to determine where it is sourced. For example, legislation provides that a dividend paid by a resident company⁵³¹ received by or accrued to a person is from a source within South Africa.⁵³² If the beneficiary has a vested right to the dividend, it is deemed to have accrued to the beneficiary.⁵³³ It retains its nature as dividend and will, consequently, be from a South African source if paid by a resident company to a non-resident beneficiary. It is submitted that the interposition of the trust between the company and the beneficiary with a vested right is irrelevant for purposes of determining the source of the dividend. For some items of income no statutory source rule exists and the common law rules will apply to determine their source.⁵³⁴ These items of income will therefore also retain their nature until they reach the vested beneficiary's hands and it is submitted that the usual common law source rules will have to be applied to determine the source of such income. Once again, the intervention of the trust between the payer of the income and the beneficiary will be irrelevant. However, in the case of a discretionary trust where the income is retained in the trust,⁵³⁵ the court in *Rosen* stated (*obiter*) that income loses its identity and character, so that, if it is subsequently paid out to the beneficiary, it may no longer be what it used to be, because the “conduit pipe” had turned itself off. The income may lose its character and identity and, thus, the beneficiary may receive only “trust income”.⁵³⁶ Therefore, in the case of the beneficiary who receives a distribution from the trust in a

⁵²⁸ *Secretary for Inland Revenue v Rosen* 1971 1 SA 172 (A) 190–191.

⁵²⁹ For a further discussion of the conduit pipe principle, see ch 8.6.3.

⁵³⁰ The beneficiary may have a vested right, either because of the terms of a vesting trust, or because the trustee of a discretionary trust exercised his or her discretion in favour of that beneficiary. In *Rosen* the court stated that “*Armstrong's* case in my view authoritatively established the conduit principle for general application in our system of taxation in appropriate circumstances” (*Secretary for Inland Revenue v Rosen* 1971 1 SA 172 (A) 188).

⁵³¹ The term dividend is defined and refers only to an amount transferred or applied by a resident company (Income Tax Act 58 of 1962 s 1).

⁵³² Income Tax Act 58 of 1962 s 9(2)(a). Legislation also provides source rules for, inter alia, royalties and interest.

⁵³³ Income Tax Act 58 of 1962 s 25B(1) and (2).

⁵³⁴ *Davis et al Juta's Commentary on Income Tax* Commentary on s 9 “general note”.

⁵³⁵ That is, the trustee decides not to distribute the income to the beneficiaries during that year.

⁵³⁶ *Secretary for Inland Revenue v Rosen* 1971 1 SA 172 (A) 190.

subsequent year, the income will not retain its nature and the source of the amount paid to the beneficiary will be the trust itself.⁵³⁷

Practically, the above argument would mean that if a trust owns shares in a South African resident company and a non-resident beneficiary has a vested right to the dividends derived from those shares,⁵³⁸ the beneficiary would have to include the amount of the dividend in his or her gross income.⁵³⁹ In this example, it would be irrelevant whether the trust was a South African resident or not. If, in the example above, the dividend was a foreign dividend,⁵⁴⁰ the statutory source rules would not apply and, based on case law, the source of the dividend would be located where the company's share register is kept.⁵⁴¹ Therefore, if the company's share register was not kept in South Africa, the dividend would not be of a South African source.

3.2.4 Income deemed to be that of another

Section 7 is an anti-avoidance provision and some of its subsections⁵⁴² apply to trusts if certain circumstances are present. The effect of the provision is that trust income is no longer taxed in the trust or in the hands of the beneficiary (as it would in terms of section 25B), but in the hands of the person to whom the income is deemed to have accrued under section 7. The type of transaction which the legislature aims to catch by these provisions is described as follows in *Ovenstone*:

“[T]hose in which a taxpayer seeks to achieve tax avoidance by donating, or disposing of income-producing property to or in favour of another under ... specified conditions or circumstances, thereby diverting its income from himself without his replacing or being able to replace it.”⁵⁴³

Section 7(2)(a) applies to married persons⁵⁴⁴ and it provides that

⁵³⁷ Since the payment of such an amount is not regarded as income that is subject to income tax (it may have capital gains tax consequences), a further discussion of how the place of the source is to be determined, falls outside the scope of this dissertation, although a logical inference seems to be that a distribution from a South African resident trust will be from a source within South Africa.

⁵³⁸ Or the trustee exercised his or her discretion in favour of a beneficiary during the relevant year, which results in the beneficiary obtaining a vested right to the relevant dividend.

⁵³⁹ The amount will be exempted from income tax by Income Tax Act 58 of 1962 s 10(1)(k)(i). Dividends tax is not addressed in this example.

⁵⁴⁰ A foreign dividend is, generally, any amount that is paid or payable by a foreign company (that is, a non-resident company) in respect of a share in that foreign company where that amount is treated as a dividend or similar payment by that foreign company for the purposes of the corporate income tax laws of the state where it has its place of effective management (Income Tax Act 58 of 1962 s 1 definition of “foreign dividend” read with the definition of “foreign company”).

⁵⁴¹ *Boyd v Commissioner for Inland Revenue* 1951 3 SA 525 (A); *Lamb v Commissioner for Inland Revenue* 1955 1 SA 270 (A).

⁵⁴² A detailed discussion of the provisions of the relevant subsections of s 7 falls outside the scope of this dissertation. The aim of this paragraph is simply to give a broad overview of the circumstances under which these sections may apply to trusts. Furthermore, other anti-avoidance sections that may be applied to trusts, such as s 80A–80L, are not referred to in this dissertation.

⁵⁴³ *Ovenstone v Secretary for Inland Revenue* 1980 2 SA 721 (A) 736.

⁵⁴⁴ The Income Tax Act 58 of 1962 s 1 contains a wide definition of the term “spouse”, namely “in relation to any person, means a person who is the partner of such person (a) in a marriage or customary union recognised

“Any income received by or accrued to any person married in or out of community of property (hereinafter referred to as the recipient) shall be deemed for the purposes of this Act to be income accrued to such person’s spouse (hereinafter referred to as the donor) if –

- (a) such income was derived by the recipient in consequence of a donation, settlement or other disposition made by the donor on or after 20 March 1991 or of a transaction, operation or scheme entered into or carried out by the donor on or after that date, and the sole or main purpose of such donation, settlement or other disposition or of such transaction, operation or scheme was the reduction, postponement or avoidance of the donor’s liability for any tax, levy or duty which, but for such donation, settlement, other disposition, transaction, operation or scheme, would have become payable by the donor under this Act or any other Act administered by the Commissioner”.

Section 7(3) provides that income shall be deemed to have been received by the parent of any minor child or stepchild if, by reason of any donation, settlement or other disposition made by that parent of that child (a) it has been received by or has accrued to or in favour of that child or has been expended for the maintenance, education or benefit of that child; or (b) it has been accumulated for the benefit of that child. Thus, if, for example, a settlor is the parent of a minor child and he or she donates an asset to a trust of which the minor child is a vested (or discretionary) beneficiary, any income arising from that donation will be attributed to the settlor and taxed in his or her hands.

Section 7(4) aims to curb the avoidance of section 7(3) by preventing parents from making donations to each other’s children. It provides that any income received by or accrued to or in favour of any minor child or stepchild of any person, by reason of any donation, settlement or other disposition made by any other person, shall be deemed to be the income of the parent of that child, if such parent or his or her spouse has made a donation, settlement or other disposition or given some other consideration in favour directly or indirectly of the said other person or his or her family.

Section 7(5) provides that if any person has made any donation, settlement or other disposition which is subject to a stipulation or condition to the effect that the beneficiaries⁵⁴⁵ shall not receive the income⁵⁴⁶ thereunder until the happening of some event (whether fixed or contingent), so much of any income as would, but for such stipulation or condition, in consequence of the donation, settlement or other disposition be received by or accrue to or in favour of the beneficiaries, shall, until the happening of that event or the death of that person, whichever first takes place, be deemed to be the income of that person. De Koker and Williams provides the following example of the application of this provision to trusts:

in terms of the laws of the Republic; (b) in a union recognised as a marriage in accordance with the tenets of any religion; or (c) in a same-sex or heterosexual union which the Commissioner is satisfied is intended to be permanent, and ‘married’, ‘husband’ or ‘wife’ shall be construed accordingly: Provided that a marriage or union contemplated in paragraph (b) or (c) shall, in the absence of proof to the contrary, be deemed to be a marriage or union out of community of property”.

⁵⁴⁵ Or some of them.

⁵⁴⁶ Or some portion of the income.

“It is submitted that the Commissioner is entitled to invoke the provisions of s 7(5) should ... a donor, A, donate assets to a trustee subject to the stipulation that the income be accumulated and not be paid to the beneficiary, B, until he reaches the age of 21. Under such circumstances, until B turns 21 or the death of A, whichever takes place first, each year’s income, although accumulated by the trustee, is deemed to be the income of A, the donor, who will be liable to tax on it. If the stipulation, that B is not to receive the income until he turns 21, were not there, B would be entitled to receive the income immediately. The Commissioner may therefore invoke s 7(5).”⁵⁴⁷

The question whether the exercise by the trustee of his or her discretion is an “event”, as contemplated in the provision, has come before the courts, but has not been conclusively decided.⁵⁴⁸ The application of section 7(5) is not limited to resident donors, trusts or beneficiaries. Thus, a non-resident donor may be taxed in terms of this section and it may apply equally to non-resident trusts.⁵⁴⁹

Section 7(6) deals, *inter alia*, with revocable trusts. It provides that if any deed of donation, settlement or other disposition contains any stipulation that the right to receive any income thereby conferred may, under powers retained by the person by whom that right is conferred, be revoked or conferred upon another, so much of any income as in consequence of the donation, settlement or other disposition is received by or accrues to or in favour of the person on whom that right is conferred, shall be deemed to be the income of the person by whom it is conferred, so long as he retains those powers. The section applies only to beneficiaries with vested rights to income.⁵⁵⁰ The section will not apply if the donor needs the co-operation of the other trustees to revoke the right to receive income. Furthermore, it is not necessary that the power to revoke is actually exercised by the donor. As long as the donor could exercise the power to revoke, the section may be applied.⁵⁵¹

Section 7(8) is specifically relevant in an international context. It provides that where, by reason of or in consequence of any donation, settlement or other disposition⁵⁵² made by any resident, any amount is received by or accrued to any person (such as a trust) who is not a resident,⁵⁵³ which would have constituted income had that person been a resident, there shall be included in the income of that resident so much of that amount as is attributable to that donation, settlement or other disposition. The provision also allows for the deduction of certain expenditure by the resident, although the deduction is limited to the amount included in the resident’s income.⁵⁵⁴ The aim of the provision is to thwart attempts by residents to move income-producing assets to, *inter alia*, non-resident trusts and to accumulate income in those trusts, thus placing the income beyond the reach of the South

⁵⁴⁷ De Koker and Williams *Silke on South African Income Tax* para 12.20.

⁵⁴⁸ Eg *Estate Dempers v Secretary for Inland Revenue* 1977 3 SA 410 (A) and *Commissioner for Inland Revenue v Berold* 1962 3 SA 748 (A).

⁵⁴⁹ De Koker and Williams *Silke on South African Income Tax* para 12.20. However, see Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 354, who points to the limitations in applying s 7(5) to non-resident trusts.

⁵⁵⁰ Davis *et al Juta's Commentary on Income Tax* Commentary on s 7(6).

⁵⁵¹ De Koker and Williams *Silke on South African Income Tax* para 12.21.

⁵⁵² Other than a donation, settlement or other disposition to an entity which is not a resident and which is similar to a public benefit organisation contemplated in section 30.

⁵⁵³ Other than a controlled foreign company in relation to such resident.

⁵⁵⁴ Income Tax Act 58 of 1962 s7(8)(b).

African tax net.⁵⁵⁵ The provision attributes the income that the non-resident trust receives to the South African resident, if the requirements of the section are met, taxing the income in his or her hands. It is unclear whether the section would operate if income is distributed to a resident beneficiary.⁵⁵⁶

In many of the subsections of section 7 the expression “donation, settlement or other disposition” is used. In *Ovenstone*, the court held that that these words must be interpreted *ejusdem generis*, so that the expression reads as “donation, settlement or other similar disposition”. Thus, the word “disposition” in this expression means any disposal of property made wholly or to an appreciable extent gratuitously out of the liberality or generosity of the disposer.⁵⁵⁷ The court summed up its findings regarding this expression as follows:

“To sum up: the critical phrase in s 7(3) – ‘any donation, settlement or other disposition’ – excludes any disposal of property that is a wholly commercial or business one, ie made for due consideration; it covers any disposal of property made wholly gratuitously out of liberality or generosity; it also covers any disposal of property made under a settlement or other disposition for some consideration but in which there is an appreciable element of gratuitousness and liberality or generosity.”⁵⁵⁸

The court added that:

“[W]here the consideration, while not being due consideration, is nevertheless appreciable, it will mean that the income in question under s 7(3) will usually have accrued or been received ‘by reason of’ both elements of gratuitousness and consideration. I see no reason why in those circumstances the income should not then be apportioned between the two elements. The words, ‘by reason of’, themselves suggest some apportionment in order to give proper effect to the real cause of the accrual or receipt of the income.”⁵⁵⁹

Section 7(9) provides that where any asset has been disposed of for a consideration which is less than the market value of such asset, the amount by which such market value exceeds such consideration shall, for the purposes of this section, be deemed to be a donation. The reason for this provision is not apparent, as the interpretation by the courts placed on the words “donation, settlement or other disposition” entails that an appreciable element of bounty must be present. Thus, a disposal of an asset for less than market value would fall within this meaning.⁵⁶⁰

Furthermore, in many of the subsections of section 7 the words “by reason of” or “in consequence of” are used. In the *Widan* case⁵⁶¹ the court held that these words indicated

⁵⁵⁵ Jooste (2002) *Acta Juridica* 186 186.

⁵⁵⁶ Jooste (2002) *Acta Juridica* 186 187–188; Davis *et al* *Juta's Commentary on Income Tax* Commentary on s 7(8).

⁵⁵⁷ *Ovenstone v Secretary for Inland Revenue* 1980 2 SA 721 (A) 737. This finding was confirmed in *Commissioner: South African Revenue Service v Woulidge* 2002 1 SA 68 (SCA) 74.

⁵⁵⁸ *Ovenstone v Secretary for Inland Revenue* 1980 2 SA 721 (A) 740.

⁵⁵⁹ *Ovenstone v Secretary for Inland Revenue* 1980 2 SA 721 (A) 740. Confirmed in *Commissioner: South African Revenue Service v Woulidge* 2002 1 SA 68 (SCA) 74.

⁵⁶⁰ De Koker and Williams *Silke on South African Income Tax* para 12.21A.

⁵⁶¹ *Commissioner for Inland Revenue v Widan* 1955 1 SA 226 (A) 234.

some causal relation between the donation and the income in question. The court held that the “real efficient cause” of the income must be ascertained, holding that “income on income” would be hit by the relevant subsection of section 7.⁵⁶²

3.2.5 Conclusion

From the above it is clear that South Africa follows the initial choice system in the classification suggested by Wheeler. If, in a year of assessment, an ascertained beneficiary with a vested right to income exists, the income will be taxed in the beneficiary’s hands. If no beneficiary has a vested right to the income (for example, when the trustee of a discretionary trust decides to accumulate the income), the trust will be taxed on the income. The trust itself could therefore be a taxpayer. If, however, any of the anti-avoidance provisions of section 7 apply, the person to whom the income is attributed in terms of that section will be taxed, and not the trust or the beneficiary. Generally, income retains its nature as it passes through a trust and the trust is a mere “conduit pipe”. Income probably does not retain its nature if it is accumulated by the trustee and distributed to beneficiaries in a later year. If a trust is liable to tax, it is taxed at a flat rate of 40%.

3.3 United Kingdom

3.3.1 Introduction

The Income Tax Act provides that the trustees of a settlement are together treated as if they were a single person (distinct from the persons who are the trustees of the settlement from time to time).⁵⁶³ In the discussion that follows, a distinction is made between discretionary trusts and fixed trusts.

3.3.2 Discretionary trusts

By way of an outline, it may be stated that the trustee of a discretionary trust is liable to tax on his or her receipt of the income and on making a discretionary payment of income. The beneficiaries are taxed on the discretionary payment. Appropriate tax credits are provided to relieve double taxation that may arise. These different levels of taxation are discussed below and, where applicable, a distinction is made between a resident and a non-resident trustee and beneficiary respectively.⁵⁶⁴

⁵⁶² The court effectively overturned the decision in *Kohler v Commissioner for Inland Revenue* 1949 4 SA 1022 (T), in which the court held that “income on income” was not hit by the section (Emslie *et al Income Tax Cases and Materials* 1007; Davis *et al Juta's Commentary on Income Tax* Commentary on s 7(3)).

⁵⁶³ Income Tax Act 2007 s 474(1).

⁵⁶⁴ Kessler describes the system as having three tiers of taxation in respect of discretionary trusts: (a) a charge on the trustee on his or her receipt of the income; (b) a charge on the trustee on making a discretionary payment of income; and (c) a charge on the beneficiaries on receiving a discretionary payment of income (Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1055–1056). In respect of Scottish trusts and beneficiaries, it should be noted that the Scotland Act 2012 introduces the Scottish rate of income tax, which is expected to be implemented in April 2016. HMRC has issued a Technical Note in which, *inter alia*, the position of Scottish trusts and beneficiaries are dealt with (Her Majesty’s Revenue and Customs *Clarifying the Scope of the Scottish Rate of Income Tax* para 45–46).

3.3.2.1 Taxation of the trustee of a discretionary trust

3.3.2.1.1 Charge on the trustee on receipt of income

There are no special charging provisions in relation to a trust and the usual charging provisions therefore apply, meaning that a trustee resident in the United Kingdom is subject to tax on all of his or her income, while a non-resident trustee is, generally speaking, only subject to tax on income from a United Kingdom source.⁵⁶⁵ The trustee is taxed because he or she is entitled to income, or because he or she receives the income. Even though a trustee is not beneficially entitled to the income, he or she may sue for it and is, in that sense, entitled to the income. The trustee may also be said to receive the income.⁵⁶⁶ A trustee that is taxed at the trust rates is taxed, in respect of accumulated or discretionary income,⁵⁶⁷ at the dividend tax rate (currently 37,5 per cent) in respect of dividend-type income and at the trust rate (currently 45 per cent) in respect of other income.⁵⁶⁸ The trustee is thus taxed irrespective of the personal circumstances of the beneficiary.⁵⁶⁹

3.3.2.1.2 Charge on the trustee on making a discretionary payment of income

The trustees are charged as follows:

- “(1) Income tax is charged for a tax year if –
- (a) in the tax year the trustees of a settlement make payments as a result of which income tax is treated as having been paid under section 494, and
 - (b) amount A is greater than amount B.
- (2) Amount A is the total amount of the income tax treated under section 494 as having been paid.
- (3) Amount B is the amount of the trustees' tax pool available for the tax year (see section 497).
- (4) The amount of the tax charged under this section is equal to the difference between amounts A and B.

⁵⁶⁵ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1057; Chamberlain and Whitehouse *Trust Taxation* para 8.38. Regarding residence of the trustee, see ch 6.3.2.1.

⁵⁶⁶ Gordon *et al* *Tiley and Collison's UK Tax Guide 2013–14* para 21.8.

⁵⁶⁷ Income is regarded as accumulated or discretionary income so far as it must be accumulated or it is payable at the discretion of the trustee of any other person, subject to certain exclusions. The section further describes when income will be regarded as payable at the discretion of the trustee (Income Tax Act 2007 s 480).

⁵⁶⁸ Income Tax Act 2007 s 479. However, the first 1 000 pounds of income taxable at the rate applicable to trusts will be taxed at either the basic rate or the dividend ordinary rate (Chamberlain and Whitehouse *Trust Taxation* para 6.33; Gordon *et al* *Tiley and Collison's UK Tax Guide 2013–14* para 21.10). See Chamberlain and Whitehouse *Trust Taxation* para 6.34 for an anti-fragmentation rule, which stops settlors from settling multiple trusts to take advantage of the first 1 000 pound bands. Furthermore, it should be noted that s 481, read with s 482, describes certain amounts, which are capital for trust purposes, but treated as income for tax purposes and which are taxed at the top income tax rates. The details of these provisions are not discussed in this dissertation.

⁵⁶⁹ Gordon *et al* *Tiley and Collison's UK Tax Guide 2013–14* para 21.8.

(5) The trustees are liable for the tax.”⁵⁷⁰

Regarding the trustees’ tax pool, section 497 provides as follows:

“(1) Take the following steps to calculate the amount of the trustees’ tax pool available for a tax year (‘the current tax year’).

This is subject to subsections (2) and (3).

Step 1

Take the amount of the trustees’ tax pool available for the previous tax year and deduct from that amount (but not so that it goes below nil) the total amount of income tax treated under section 494 as having been paid as a result of payments made by the trustees in the previous tax year.

Step 2

Add together all amounts of income tax for which the trustees are liable for the current tax year and which are of a type set out in section 498.

Step 3

Add the sum calculated at Step 2 to the amount resulting from Step 1.

(2) If the trustees were non-UK resident for the previous tax year, references in subsection (1) to the previous tax year are to be read as references to the last tax year prior to the current tax year for which the trustees were UK resident.

(3) If –

(a) the current tax year is the tax year during which the settlement is established, or

(b) the trustees have been UK resident for no tax year prior to the current tax year,

ignore Steps 1 and 3 and, accordingly, the trustees’ tax pool available for the current tax year is the sum calculated at Step 2.”⁵⁷¹

3.3.2.2 Taxation of the beneficiary

3.3.2.2.1 Charge on the beneficiaries on receiving a discretionary payment of income

In terms of the Income Tax (Trading and Other Income) Act, payments from a discretionary trust are subject to income tax in the hands of a resident beneficiary.⁵⁷² In the case of a non-

⁵⁷⁰ Income Tax Act 2007 s 496.

⁵⁷¹ Income Tax Act 2007 s 497. S 498 lists the types of income that fall within the tax pool. In effect, the taxes paid by the trustee on the receipt of income (and discussed in para 3.3.2.1.1) enters a tax pool and may be credited against the tax paid by the trustee on making a discretionary payment (and discussed in para 3.3.2.1.2), with the result that no tax may be paid by the trustee on making a discretionary payment (Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1056).

resident beneficiary, he or she is only liable to tax in respect of income from a source in the United Kingdom.⁵⁷³ If a beneficiary receives income from the trust after the trustee has exercised his or her discretion in favour of the beneficiary, the trust will be the source of the income, and not the underlying assets. Thus, the beneficiary's income is classified as an annual payment, regardless of the type of income received by the trustee, a view with which Her Majesty's Revenue and Customs (HMRC) agree.⁵⁷⁴ The income is regarded as being from a United Kingdom source if the trustee is resident in the United Kingdom.⁵⁷⁵ A beneficiary receives income on the date that the trustee makes the payment to him or her, or on the date that the beneficiary becomes legally entitled to compel the trustee to pay over the income.⁵⁷⁶

A United Kingdom resident beneficiary is entitled to a tax credit equal to the income tax (at the trust rate on the grossed-up amount of the discretionary payment).⁵⁷⁷ A beneficiary that is not resident in the United Kingdom can only receive the tax credit if the trustee is resident in the United Kingdom.

However, if the trustee decides to retain income as part of the capital of the trust, the accumulated sum loses its character as income and is treated as capital. Hence, any subsequent distribution to the beneficiary is not subject to income tax.⁵⁷⁸

3.3.2.2.2 Discretionary trust treated as transparent

Domestic law in the United Kingdom allows the beneficiary of a United Kingdom resident trust (and subject to certain requirements) to claim that the payment of an amount was received by the beneficiary himself (or herself) and not by the trust.⁵⁷⁹ The reason for this provision is that it allows the beneficiary to claim relief from double taxation. Furthermore, provided certain conditions are met, HMRC will allow a beneficiary of a United Kingdom resident trust to claim an exemption or relief if the trustee made a payment out of income of the trustee, in respect of which, had it been received directly, the beneficiary would, *inter alia*, (a) have been entitled to relief under the terms of a DTT, or (b) not have been chargeable to United Kingdom tax because of their not resident and/or not ordinarily

⁵⁷² Income Tax (Trading and Other Income) Act 2005 ss 577(1) and 683(1); Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1061.

⁵⁷³ Income Tax (Trading and Other Income) Act 2005 s 577(2).

⁵⁷⁴ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1062; Chamberlain and Whitehouse *Trust Taxation* para 6.37.

⁵⁷⁵ See Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1063, who also states that HMRC agrees with this view.

⁵⁷⁶ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1064.

⁵⁷⁷ Income Tax Act 2007 ss 493–494; Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1064–1065.

⁵⁷⁸ Chamberlain and Whitehouse *Trust Taxation* para 6.38; Gordon *et al* *Tiley and Collison's UK Tax Guide 2013–14* para 21.18. However, the distribution may have capital gains tax consequences.

⁵⁷⁹ Taxation (International and Other Provisions) Act 2010 s 111. The detail of this provision will not be discussed in this dissertation.

resident status.⁵⁸⁰ In a similar vein, there is also relief for a non-resident beneficiary who receives a payment from a non-resident trustee.⁵⁸¹

3.3.3 Fixed trusts

3.3.3.1 Taxation of the trustee

In principle, the trustee of a trust is liable to tax on income received by him or her if the trustee is resident in the United Kingdom.⁵⁸² In the case of a non-resident trustee, the trustee is liable to tax on income from a United Kingdom source.⁵⁸³ However, these statements are subject to a number of exceptions.⁵⁸⁴

Sometimes a trustee mandates⁵⁸⁵ income to a beneficiary. In such a case there is no statutory basis for taxing the trustee as he or she does not receive the income. The beneficiary not only receives the income, but is also entitled to it and, consequently, the trustee is not taxed on the mandated income.⁵⁸⁶

3.3.3.2 Taxation of the beneficiary

If the beneficiary of a fixed trust is a United Kingdom resident, he or she is liable to income tax on the income received from the trust.⁵⁸⁷ In the case of a non-resident beneficiary, he or she is liable to income tax on income if it is from a United Kingdom source.⁵⁸⁸ Generally speaking, if a beneficiary is entitled to the income of an English law trust (and certain other jurisdictions called “Baker jurisdictions”),⁵⁸⁹ the trust itself is not the source of the income, but the underlying assets are. In other jurisdictions (called “Garland jurisdictions”)⁵⁹⁰ the beneficiary does not have a specific interest in each and every trust asset and the trust is therefore seen as the source of the income.⁵⁹¹

⁵⁸⁰ Her Majesty’s Revenue and Customs *Extra-Statutory Concessions* B18; Chamberlain and Whitehouse *Trust Taxation* para 6.40.

⁵⁸¹ Her Majesty’s Revenue and Customs *Extra-Statutory Concessions* B18. The detail of this concession will not be discussed in this dissertation.

⁵⁸² According to Chamberlain and Whitehouse, a trustee is liable to tax at the basic rate on income other than dividends and at the dividend rate on dividends (Chamberlain and Whitehouse *Trust Taxation* para 6.06).

⁵⁸³ Chamberlain and Whitehouse *Trust Taxation* para 6.10.

⁵⁸⁴ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1109.

⁵⁸⁵ The beneficiary receives the income and the trustee does not.

⁵⁸⁶ Her Majesty’s Revenue and Customs *Manual on Trusts* paras TSEM3040 and TSEM3763; Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1098 and 1109; Chamberlain and Whitehouse *Trust Taxation* para 6.12.

⁵⁸⁷ The beneficiary is so liable when he or she becomes entitled to the income, even if none of the money is paid to him or her during the relevant year (Chamberlain and Whitehouse *Trust Taxation* para 6.14).

⁵⁸⁸ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1094.

⁵⁸⁹ The name originates from the decision in *Baker v Archer-Shee* [1927] AC 844 HL.

⁵⁹⁰ The name originates from the decision in *Archer-Shee v Garland* (1931) 15 TC 693.

⁵⁹¹ Chamberlain and Whitehouse *Trust Taxation* para 6.15; Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1095–1096. These rules are controversial (Hardy in *Topical Analysis* 4.3.2; Wheeler in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 45). Some courts doubt whether it should always apply (*R (on the application of Huitson) v HMRC* [2010] EWHC 97 (Admin)). Under common law the trust is regarded as the source of the income under a life rent in a Scottish trust. However, this position was reversed by Income Tax Act 2007 s 464.

If the trustee of a trust has paid tax on an amount, or if the trustee received the amount with the tax deducted at source, the beneficiary is given a credit for that tax.⁵⁹² In cases where the trustee mandates the income to the beneficiary, it is the beneficiary that is taxed on that income.⁵⁹³

If income is received from abroad, the trustee resident in the United Kingdom is not liable to tax if that income is paid to a non-resident beneficiary.⁵⁹⁴

3.3.4 Settlor-interested trusts⁵⁹⁵

The trustee of a settlor-interested trust is subject to tax at the same rates as the trustee of a discretionary trust. However, income is also taxed in the hands of the settlor if it is treated as his or her income. The settlor is therefore entitled to a credit for the taxes paid by the trustee at the appropriate rate.⁵⁹⁶

The Income Tax (Trading and Other Income) Act provides that:

“Income which arises under a settlement is treated for income tax purposes as the income of the settlor and of the settlor alone if it arises

- (a) during the life of the settlor, and
- (b) from property in which the settlor has an interest.”⁵⁹⁷

Regarding the meaning of the phrase “income which arises under a settlement”, it is provided that

“References in this Chapter to income arising under a settlement include

- (a) any income chargeable to income tax by deduction or otherwise, and
- (b) any income which would have been so chargeable if it had been received in the United Kingdom by a person domiciled, resident and ordinarily resident there.”⁵⁹⁸

Notably, the income payable to a beneficiary with a fixed interest is regarded as “income which arises under a settlement”, even if it is taxed in the hands of the beneficiary.⁵⁹⁹

⁵⁹² Chamberlain and Whitehouse *Trust Taxation* para 6.26.

⁵⁹³ Her Majesty’s Revenue and Customs *Manual on Trusts* para TSEM3765.

⁵⁹⁴ Her Majesty’s Revenue and Customs *Manual on Trusts* para TSEM3160.

⁵⁹⁵ Chamberlain and Whitehouse question whether this type of anti-avoidance legislation is really necessary, given that the settlor often obtains no great advantage from diverting income to a trust (Chamberlain and Whitehouse *Trust Taxation* para 7.02).

⁵⁹⁶ Gordon *et al* *Tiley and Collison’s UK Tax Guide 2013–14* para 21.14.

⁵⁹⁷ Income Tax (Trading and Other Income) Act 2005 s 624(1). The Income Tax Act 2007 s 720 deals with the avoiding of liability to income tax by individuals who are ordinarily UK resident by means of relevant transfers. According to Kessler, Income Tax (Trading and Other Income) Act 2005 s 624 and Income Tax Act 2007 s 720 cover similar ground, but s 624 will have priority over s 720 (Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1146–1147; Chamberlain and Whitehouse *Trust Taxation* para 8.02). Also note that Income Tax Act 2007 s 624 applies only to individuals and not to corporate settlors (Income Tax (Trading and Other Income) Act 2005 627(4)).

⁵⁹⁸ Income Tax (Trading and Other Income) Act 2005 s 648(1).

⁵⁹⁹ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1126.

A settlor has an interest in property if there are any circumstances in which the property or any related property⁶⁰⁰ is payable or applicable for the benefit of the settlor (or the settlor's spouse or civil partner); or will or may become so payable or applicable.⁶⁰¹ According to Chamberlain and Whitehouse, cases where the trust fund reverts to the settlor under a revocable settlement, or where the settlor is a discretionary beneficiary (or could be added as such), are examples where the settlor will be regarded as having an interest in property. However, the power to participate in the management of the trust is not sufficient to constitute an interest in property.⁶⁰²

In order to avoid double taxation, relief is provided to a discretionary beneficiary⁶⁰³ of a settlor-interested trust (who is not the settlor) on the income paid to the beneficiary. The relief entails a tax credit for the tax paid by the trustee on behalf of the settlor.⁶⁰⁴ If the settlor is also a beneficiary, the payment to him or her is not treated as his or her income for income tax purposes.⁶⁰⁵

In the case of a non-resident settlor, only income which is of a United Kingdom source is treated as that of the settlor. Thus, if the trust is resident in the United Kingdom, but the settlor is not, the trust is taxed in full on the income that is not of a United Kingdom source and the settlor is taxed on the income that is from a United Kingdom source. If both the trust and the settlor are non-residents, neither is taxed on income that is not from a United Kingdom source, but the settlor will be taxed on income that is from a United Kingdom source.⁶⁰⁶

3.3.5 Payments to minor unmarried children of the settlor

Income which arises under a settlement and that is paid during the settlor's lifetime to or for the benefit of an unmarried minor child of the settlor⁶⁰⁷ is treated for income tax purposes as the income of the settlor in the tax year in which it is distributed.⁶⁰⁸ If the amount paid to the child is less than 100 pounds, it is not taxed to the settlor.⁶⁰⁹ However, if income is

⁶⁰⁰ "[R]elated property', in relation to any property, means income from that property or any other property directly or indirectly representing proceeds of, or of income from, that property or income from it" (Income Tax (Trading and Other Income) Act 2005 s 625(5)).

⁶⁰¹ Income Tax (Trading and Other Income) Act 2005 s 625. There are a number of exceptions to this general rule which are not discussed in this dissertation.

⁶⁰² Chamberlain and Whitehouse *Trust Taxation* paras 7.07 and 7.10.

⁶⁰³ The statutory relief applies only to discretionary trusts, but no relief is needed in the case of a fixed trust since the beneficiary is not taxable as the trust income is the income to the settlor (and him or her alone) (Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1136).

⁶⁰⁴ Income Tax (Trading and Other Income) Act 2005 s 685A.

⁶⁰⁵ Income Tax (Trading and Other Income) Act 2005 s 685A(5). The legislation also provides relief to remittance basis taxpayers, but a discussion of this relief falls outside the scope of this dissertation (Income Tax (Trading and Other Income) Act 2005 s 648).

⁶⁰⁶ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 1142–1143, who also notes that later remittance of the income by the trust whilst the settlor is resident is irrelevant. See also Chamberlain and Whitehouse *Trust Taxation* para 7.20.

⁶⁰⁷ Or would otherwise be treated (apart from this section) as income of an unmarried minor child of the settlor.

⁶⁰⁸ Income Tax (Trading and Other Income) Act 2005 s 629(1); Chamberlain and Whitehouse *Trust Taxation* para 7.38. However, if Income Tax (Trading and Other Income) Act 2005 s 624 applies, that section will take precedence and not s 629(1).

⁶⁰⁹ Income Tax (Trading and Other Income) Act 2005 s 629(3).

accumulated in the (irrevocable) trust, the income is not taxed in the settlor's hands, but if it is distributed at a later stage to a child who is under the age of eighteen years and unmarried, the distributions (up to the amount of the accumulations) are treated as the settlor's income. Since the trustee would have already paid tax on the accumulated income, the settlor is granted an appropriate credit for the taxes so paid.⁶¹⁰

3.3.6 Transfer of assets abroad

Wheeler sums up the effect of this piece of legislation⁶¹¹ as follows:

"[It] operates to attribute income from an asset to an individual who is ordinarily resident and who transfers the income-producing asset to a non-resident. It is triggered if income becomes payable to the non-resident as a result of the transfer and/or any connected operations, and the transferor or his/her spouse has the power to enjoy the income or receives a capital sum connected with the transfer. The legislation prescribes five sets of circumstances in which an individual is regarded as having the power to enjoy income. Those circumstances include the individual being able to receive any benefit out of the income, and the receipt or accrual of the income operating to increase the value to the individual of any assets held by him or for his benefit."⁶¹²

The legislation may also affect non-resident trusts.⁶¹³ If the legislation dealing with transfer of assets abroad overlaps with the legislation regarding settlor-interested trusts, the latter will apply.⁶¹⁴

3.3.7 Conclusion

It is clear from the above that the United Kingdom uses the credit system described by Wheeler as a means of taxing trusts and their beneficiaries. The trustees are, by legislation, together treated as if they were a single, distinct person. Broadly speaking, a trustee of a discretionary trust is taxed on discretionary and accumulated income of the trustee and also on the making of a discretionary payment of income to a beneficiary. The beneficiary is liable to tax on the amount received from the trustee, but is given a credit for the taxes paid by the trustee. If income is accumulated beyond the tax year, it loses its character as income and is treated as capital when distributed to the beneficiary. Generally, in the case of a fixed trust, the trustee is liable to tax on his or her income. The beneficiaries are also liable to tax on their income from the trust, but are given a credit for the tax paid by the trust. In the case of a settlor-interested trust or where payments are made to the minor unmarried children of

⁶¹⁰ Chamberlain and Whitehouse *Trust Taxation* para 7.39. The payment of certain capital benefits by the trustee to a settlor may, under certain circumstances, be regarded as taxable in the settlor's hands, eg when a loan is repaid. However, a discussion of these provisions (Income Tax (Trading and Other Income) Act 2005 ss 633–634) falls outside the scope of this dissertation.

⁶¹¹ Income Tax Act 2007 ss 714–751.

⁶¹² Wheeler (2011) 3 *World Tax Journal* 39 84. The legislation dealing with transfer of assets abroad is, of course, complex and the quoted paragraph gives a very high level overview thereof. However, this overview is regarded as sufficient for purposes of this dissertation.

⁶¹³ See the cases cited by Wheeler (2011) 3 *World Tax Journal* 39 84–85 and the examples given by Chamberlain and Whitehouse *Trust Taxation* 208.

⁶¹⁴ Chamberlain and Whitehouse *Trust Taxation* 208.

the settlor, the income is taxed in the hands of the settlor. Appropriate credits are granted to avoid double taxation.

3.4 Canada

3.4.1 Introduction⁶¹⁵

A trust is deemed to be an individual for income tax purposes.⁶¹⁶ This implies that a trust is taxed as a separate taxpayer from the settlor or beneficiary⁶¹⁷ and it is liable to tax on its income earned during the year.⁶¹⁸ Although trusts are taxed like individuals, *inter vivos* trusts pay tax at the top marginal rate,⁶¹⁹ while testamentary trusts pay tax at the graduated rate schedule⁶²⁰ similar to individuals.

In the following paragraphs, the position of Canadian resident trusts and beneficiaries is discussed first under the relevant headings. It is followed by a discussion of the taxation of non-resident trusts and non-resident beneficiaries.

3.4.2 The taxation of trusts⁶²¹

Income is taxed in the trust insofar as it is not taxed in the hands of the beneficiary. Thus, a trust is allowed a deduction for the amount of income that is taxable in the hands of the beneficiary.⁶²² It follows that a trust is only liable to tax on the income accumulated in the hands of the trustee(s), that is, income that is not paid or payable in the year to a beneficiary.⁶²³ Losses may, however, not be allocated to a beneficiary.⁶²⁴ Nevertheless, the Income Tax Act makes it possible for the trustee to deduct less than the full amount paid or payable to a beneficiary.⁶²⁵ Such an amount is designated to be taxed in the hands of the trust and is paid to the beneficiary tax-free.⁶²⁶

⁶¹⁵ Only federal income tax will be described in this paragraph. In terms of the Canadian Constitution each province also has the ability to levy income tax (see ch 2.4.1), but a discussion of the provincial taxation of trusts falls outside the scope of this dissertation.

⁶¹⁶ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(2).

⁶¹⁷ Hogg *et al Principles of Canadian Income Tax Law* 540; Ewens *Canada Tax Service - McCarthy Tetrault Analysis* 104–22; Brown in *Topical Analysis* para 4.3.1.

⁶¹⁸ Hogg *et al Principles of Canadian Income Tax Law* 544.

⁶¹⁹ Income Tax Act RSC 1985 (5th supp) ch 1 s 122(1).

⁶²⁰ Income Tax Act RSC 1985 (5th supp) ch 1 s 117(2)

⁶²¹ The Income Tax Act RSC 1985 (5th supp) ch 1 s 104(23) contains provisions relating specifically to testamentary trusts. These provisions deal, *inter alia*, with the tax year of testamentary trusts, the computation of the beneficiary's income from such a trust and the payment by the trust of taxes (Ewens *Canada Tax Service - McCarthy Tetrault Analysis* 97). A discussion of these provisions falls outside the scope of this dissertation.

⁶²² Income Tax Act RSC 1985 (5th supp) ch 1 s104(6). See also Hogg *et al Principles of Canadian Income Tax Law* 544–545 and Brown in *Topical Analysis* para 4.3.2.1. Income Tax Act RSC 1985 (5th supp) ch 1 s104(12) allows for a deduction in respect of trust income in the case of a preferred beneficiary election (see ch 3.4.3.).

⁶²³ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 78.

⁶²⁴ Hogg *et al Principles of Canadian Income Tax Law* 545; Brown in *Topical Analysis* 4.3.1.

⁶²⁵ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(13).

⁶²⁶ The purpose of this provision is to take advantage of losses in the trust, but the provision holds other practical advantages as well (Hogg *et al Principles of Canadian Income Tax Law* 545; Ewens *Canada Tax Service - McCarthy Tetrault Analysis* 80).

If expenses are incurred by the trust to earn its income, it may be deducted by the trust in the normal manner.⁶²⁷ Furthermore, a trust that is subject to the tax at a rate of 36 per cent in respect of income payable to non-resident beneficiaries,⁶²⁸ may deduct the tax so payable.⁶²⁹

3.4.3 The taxation of beneficiaries

If income is payable to a beneficiary⁶³⁰ in a tax year and deducted by the trust from its income, that income must be included in the income of the beneficiary.⁶³¹ However, as explained above, income that is designated to the trust and taxed in the trust's hands, is not included in the beneficiary's income, although it is payable to the beneficiary.⁶³² Income is payable to a beneficiary if it was paid to the beneficiary in the taxation year or the beneficiary was entitled⁶³³ in the taxation year to enforce payment of it.⁶³⁴ Where the trustee has no discretion as to whether income must be paid to a beneficiary, it will automatically be regarded as payable to that beneficiary when it is derived by the trust. In the case of a discretionary trust, the exercise by the trustee of his or her discretion to pay an amount to a beneficiary (typically by way of a resolution) will result in that income being regarded as payable to the beneficiary. Even if the amount is only paid in the following year,

⁶²⁷ Ewens *Canada Tax Service - McCarthy Tetrault Analysis* 97; Brown in *Topical Analysis* para 4.3.1.

⁶²⁸ The tax at a rate of 36 per cent is discussed in greater detail in ch 3.4.6.

⁶²⁹ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(30); Brown in *Topical Analysis* para 4.3.1.

⁶³⁰ It is important to determine when a person can be regarded as a beneficiary for income tax purposes. The Income Tax Act RSC 1985 (5th supp) ch 1 s 108 provides that a "beneficiary" under a trust includes a person beneficially interested therein." In turn Income Tax Act RSC 1985 (5th supp) ch 1 s 248(25) provides that "(a) a person or partnership beneficially interested in a particular trust includes any person or partnership that has any right (whether immediate or future, whether absolute or contingent or whether conditional on or subject to the exercise of any discretion by any person or partnership) as a beneficiary under a trust to receive any of the income or capital of the particular trust either directly from the particular trust or indirectly through one or more trusts or partnerships; (b) except for the purpose of this paragraph, a particular person or partnership is deemed to be beneficially interested in a particular trust at a particular time where (i) the particular person or partnership is not beneficially interested in the particular trust at the particular time, (ii) because of the terms or conditions of the particular trust or any arrangement in respect of the particular trust at the particular time, the particular person or partnership might, because of the exercise of any discretion by any person or partnership, become beneficially interested in the particular trust at the particular time or at a later time, and (iii) at or before the particular time, either (A) the particular trust has acquired property, directly or indirectly in any manner whatever, from (I) the particular person or partnership, (II) another person with whom the particular person or partnership, or a member of the particular partnership, does not deal at arm's length, (III) a person or partnership with whom the other person referred to in subclause 248(25)(b)(iii)(A)(II) does not deal at arm's length, (IV) a controlled foreign affiliate of the particular person or of another person with whom the particular person or partnership, or a member of the particular partnership, does not deal at arm's length, or (V) a non-resident corporation that would, if the particular partnership were a corporation resident in Canada, be a controlled foreign affiliate of the particular partnership, or (B) a person or partnership described in any of subclauses 248(25)(b)(iii)(A)(I) to 248(25)(b)(iii)(A)(V) has given a guarantee on behalf of the particular trust or provided any other financial assistance whatever to the particular trust; and (c) a member of a partnership that is beneficially interested in a trust is deemed to be beneficially interested in the trust."

⁶³¹ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(6)(b) read with s 104(13); Ewens *Canada Tax Service - McCarthy Tetrault Analysis* 59.

⁶³² Income Tax Act RSC 1985 (5th supp) ch 1 s 104(13.1).

⁶³³ "Entitled" means legally entitled (Ewens *Canada Tax Service - McCarthy Tetrault Analysis* 51).

⁶³⁴ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(24).

provided that the appropriate resolution was taken in the tax year, the amount will be regarded as payable to the beneficiary.⁶³⁵

Subject to certain exceptions,⁶³⁶ the value of all benefits to a taxpayer from or under a trust must be included in computing the taxpayer's income for the year.⁶³⁷ Thus, amounts paid to third parties for expenses incurred for the benefit of beneficiaries are considered income payable to a beneficiary.⁶³⁸ A further example is the rental of property to the beneficiary for an artificially low rent.⁶³⁹ The value of these benefits is included in the income of the taxpayer and cannot be deducted by the trust.⁶⁴⁰

In terms of the preferred beneficiary election, the trust and a preferred beneficiary may jointly elect that part of the accumulating income (that is, income that is not payable to a beneficiary) of the trust for the particular year is to be included in the income of the preferred beneficiary, subject to certain limitations.⁶⁴¹ A preferred beneficiary must meet certain criteria, including that the beneficiary must suffer from a mental or physical impairment, or be dependent on another because of a mental or physical infirmity.⁶⁴² The purpose of these provisions is to allow a preferred beneficiary to elect to include in his or her income the income of the trust that is being accumulated for the preferred beneficiary's benefit. In effect, the income (which did not become payable to the preferred beneficiary) is taxed at the preferred beneficiary's rates and not at the trust's rates.⁶⁴³ However, the attribution rules discussed below may still apply to attribute the income to the settlor, despite the preferred beneficiary election.⁶⁴⁴

If an amount was taxed in the trust (because it was not paid or payable to a beneficiary in a particular year or was designated to be taxed in the trust)⁶⁴⁵ and subsequently paid out to the beneficiary, the amount so paid to the beneficiary is not subject to tax in the beneficiary's hands.⁶⁴⁶

3.4.4 Flow-through character of income

As a general rule, income included in the hands of a beneficiary of a trust, is deemed to be income from a property that is an interest in the trust and not from any other source.⁶⁴⁷

⁶³⁵ Hogg *et al Principles of Canadian Income Tax Law* 547.

⁶³⁶ One of these exceptions is that if an amount has been included in the beneficiary's income under s 104(13), it is not included again in terms of s 105(1).

⁶³⁷ Income Tax Act RSC 1985 (5th supp) ch 1 s 105(1).

⁶³⁸ Hogg *et al Principles of Canadian Income Tax Law* 548.

⁶³⁹ Ewens *Canada Tax Service - McCarthy Tétrault Analysis* 107.

⁶⁴⁰ Hogg *et al Principles of Canadian Income Tax Law* 548; Ewens *Canada Tax Service - McCarthy Tétrault Analysis* 108–109.

⁶⁴¹ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(14) and (15).

⁶⁴² The definition of "preferred beneficiary" is contained in Income Tax Act RSC 1985 (5th supp) ch 1 s 108 and refers to other requirements as well.

⁶⁴³ Brown in *Topical Analysis* para 4.3.2.1.

⁶⁴⁴ Ewens *Canada Tax Service - McCarthy Tétrault Analysis* 67.

⁶⁴⁵ See ch 3.4.2 above.

⁶⁴⁶ Hogg *et al Principles of Canadian Income Tax Law* 550; Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 79.

⁶⁴⁷ Income Tax Act RSC 1985 (5th supp) ch 1 s 108(5).

Thus, income derived by the trust from various sources loses its character when it flows through to the beneficiaries.⁶⁴⁸ There are, however, a number of important exceptions to this rule, which means that the income will not lose (but rather retain) its character when it flows through to the beneficiary.⁶⁴⁹ For example, dividends received by the trust on a share in a Canadian resident corporation retain its nature if it is included in the beneficiary's income and the trust so designated it.⁶⁵⁰ A further example is foreign source income received by the trust. It retains its nature when so designated by the trust and included in the income of the beneficiary.⁶⁵¹

3.4.5 Income taxed in the hands of the settlor

Although income is usually taxed in the hands of either the trust or the beneficiaries, certain anti-avoidance provisions attribute the income to the settlor.

Section 74.1 provides that if an individual has transferred or lent property, either directly or indirectly, by means of a trust, to or for the benefit of a person who is the individual's spouse or common-law partner, any income or loss from the property or from property substituted therefor, is deemed to be income or a loss of the individual.⁶⁵² It further provides that if an individual has transferred or lent property, either directly or indirectly, by means of a trust to or for the benefit of a related minor,⁶⁵³ any income or loss of that person from the property or from property substituted for that property is deemed to be income or a loss of the individual.⁶⁵⁴ The purpose of these rules is to prevent income splitting between family members.⁶⁵⁵ Payments of income from transferred property that are made to a spouse or minor in the exercise of a discretion by the trustee, will still be attributed to the individual. Income accumulated in a trust for the benefit of a spouse or related minor is not subject to attribution.⁶⁵⁶

Section 75(2) provides that where property is held by a trust on condition (a) that it or property substituted therefor may (i) revert to the person from whom the property was directly or indirectly received (in this subsection referred to as "the person"), or (ii) pass to persons to be determined by the person at a time subsequent to the creation of the trust, or (b) that, during the existence of the person, the property shall not be disposed of except with the person's consent or in accordance with the person's direction, any income or loss

⁶⁴⁸ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 82.

⁶⁴⁹ Hogg *et al Principles of Canadian Income Tax Law* 549; Brown in *Topical Analysis* para 4.3.2.1.

⁶⁵⁰ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(19) and (20). Hogg *et al Principles of Canadian Income Tax Law* 549. The beneficiary may then use the Canadian dividends tax credit (Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 83).

⁶⁵¹ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(22); Hogg *et al Principles of Canadian Income Tax Law* 550. The beneficiary can therefore directly claim the tax credit attached to the foreign income (Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 84).

⁶⁵² Income Tax Act RSC 1985 (5th supp) ch 1 s 74.1(1).

⁶⁵³ That is a person under the age of 18 years who is related to the individual making the transfer as a child, other descendant, brother, sister, niece or nephew (Hogg *et al Principles of Canadian Income Tax Law* 551).

⁶⁵⁴ Income Tax Act RSC 1985 (5th supp) ch 1 s 74.1(2).

⁶⁵⁵ Hogg *et al Principles of Canadian Income Tax Law* 551.

⁶⁵⁶ Hogg *et al Principles of Canadian Income Tax Law* 552.

from the property or from property substituted for the property shall, during the existence of the person while the person is resident in Canada, be deemed to be income or a loss of the person. Due to this section, it is not advisable, from a tax point of view, to establish a trust of which the settlor is the sole trustee.⁶⁵⁷ The section may even operate in circumstances where there is more than one trustee, of which the settlor is one, but the trustees must act jointly.⁶⁵⁸

If a trust is subject to section 75(2), a Canadian resident settlor is taxable on the trust's worldwide income irrespective of whether the trust is resident or non-resident. However, in the case of a non-resident settlor of such a trust, he or she is taxable only on the trust's Canadian source income.⁶⁵⁹

3.4.6 Non-resident trusts and non-resident beneficiaries

In the case of a resident *inter vivos* trust with, *inter alia*, non-resident beneficiaries, the trust may be taxed at the rate of 36 per cent⁶⁶⁰ on the least of (a) the designated income⁶⁶¹ of the trust for the year, (b) the amount that, but for subsections 104(6) and 104(30), would be the income of the trust for the year, and (c) 100/64 of the amount deducted under paragraph 104(6)(b) in computing the trust's income under Part I for the year, to the extent that such income is payable to beneficiaries in that tax year.⁶⁶² In addition the trust must withhold tax on the remaining amount (that is, the amount remaining after the 36 per cent of tax has been deducted) which is distributed to non-resident beneficiaries. The withholding tax is discussed in more detail below.

If a Canadian resident trust pays income to a non-resident beneficiary and, generally speaking, the amount would have been included in the beneficiary's income had the beneficiary been a Canadian resident,⁶⁶³ the payment is subject to a withholding tax of 25 per cent.⁶⁶⁴ The withholding tax may, of course, be reduced by a DTT. The trustee is obliged to withhold the tax from the payment to the beneficiary.

The Income Tax Act contains a provision aimed at preventing a non-resident trust, which carries on business in Canada, from escaping Canadian tax because its income was entirely payable to beneficiaries who fall outside the Canadian tax net. Thus, if income of a trust that is not resident in Canada throughout its tax year is payable to, *inter alia*, beneficiaries who

⁶⁵⁷ Brown in *Topical Analysis* para 1.4.2.

⁶⁵⁸ Hogg *et al Principles of Canadian Income Tax Law* 553.

⁶⁵⁹ Brown in *Topical Analysis* para 4.2.1.

⁶⁶⁰ In addition to the federal tax of 29 per cent.

⁶⁶¹ Designated income is summarised by Brown as "all income earned by the trust from the conduct of a business in Canada or from the ownership of Canadian real property, resource property, or timber property and on taxable capital gains arising from the disposition of such businesses or properties" (Brown in *Topical Analysis* para 4.3.1).

⁶⁶² Brown in *Topical Analysis* para 4.3.1; Income Tax Act RSC 1985 (5th supp) ch 1 s 210.2(1).

⁶⁶³ Thus the amount is reduced by the trust's deductible expenses and losses. However, the amount includes dividends that would otherwise be exempt from tax in the trust (or in the hands of beneficiaries who are resident in Canada) (Brown in *Topical Analysis* para 4.3.3).

⁶⁶⁴ Income Tax Act RSC 1985 (5th supp) ch 1 s 212(1)(c); Brown in *Topical Analysis* para 4.3.3.

are non-resident persons (subject to certain exceptions relating to beneficiaries who are subject to Canadian tax), the income cannot be deducted by the trust.⁶⁶⁵

Section 94(3) deems certain non-resident trusts to be resident in Canada.⁶⁶⁶ This provision has been explained by the Canadian Department of Finance as follows:

“New section 94 of the Act takes a different approach to the taxation of non-resident trusts (NRTs). In general, if a Canadian resident contributes property to a NRT (other than an ‘exempt foreign trust’), the NRT is deemed to be resident in Canada for a number of purposes, and the contributor (excepting electing contributors in respect of the NRT), the NRT and certain Canadian resident beneficiaries of the NRT may all become jointly and severally, or solidarily, liable to pay Canadian tax on the income of the trust. The existing rules that limit the ability to enforce this liability against a beneficiary will continue to apply to certain beneficiaries and contributors. For more details on this limit, see the commentary on subsections 94(7) to (9).

More specifically, new section 94 divides the NRT into two notional portions. The ‘resident portion’ of the trust generally includes all property of the trust in respect of which there has been a contribution by a current or former resident of Canada, and certain other non-contributed amounts. The ‘non-resident portion’ of the trust generally includes all other property of the trust. The NRT generally is not taxed on income derived from its non-resident portion, unless the income is from certain Canadian sources.

In computing its income under the Act, the NRT will have the ordinary deductions available, under subsections 104(6) and (12), for certain amounts in respect of beneficiaries. After claiming any such deductions, the NRT will then have available a deduction in respect of amounts included in the income of an ‘electing contributor’ in respect of the trust.

New section 94 is intended to apply to NRTs where the amount to be distributed to a beneficiary of the trust depends upon a discretionary power, but may also apply to a trust in which all interests are ‘fixed interests’ if the trust is not an ‘exempt foreign trust’ as defined in subsection 94(1) (which can include cases where the trust elects not to be an exempt foreign trust). The new rules are not intended to impact upon legitimate commercial trusts. In respect of these NRTs, existing paragraph 94(1)(d) is carried forward, with some modifications, as new section 94.2 of the Act. For more information, see the commentary on new section 94.2.”⁶⁶⁷

If a trust is deemed to be resident in Canada in terms of this section and has Canadian source income, the amount that a trust can deduct, if it makes a distribution to a non-resident beneficiary, is limited.⁶⁶⁸

⁶⁶⁵ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(7).

⁶⁶⁶ See ch 6.3.3.2 for a discussion of this provision.

⁶⁶⁷ Minister of Finance *Explanatory Notes Relating to the Income Tax Act, the Excise Tax Act and Related Legislation* 15–16.

⁶⁶⁸ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(7.01) and Ewens *Canada Tax Service - McCarthy Tetrault Analysis* 53–54. This provision is not dealt with in detail in this dissertation.

Non-resident trusts that are not subject to section 94(3) are subject to tax on income having a substantial economic connection to Canada⁶⁶⁹ and are subject to withholding tax on income that is otherwise sourced in Canada.⁶⁷⁰

If a non-resident trust distributes income to a Canadian resident beneficiary, the amounts are taxable if they are in the form of income, and are not taxable otherwise. However, income is not defined for this purpose. The income does not retain its nature for Canadian tax purposes (treated as income from property) and a Canadian resident beneficiary is unable to obtain credit for foreign taxes paid by the trust.⁶⁷¹

3.4.7 Conclusion

Canada may be regarded as utilising the deduction system to ensure that double taxation between the trust and the beneficiary is avoided.⁶⁷² A trust is regarded as an individual for income tax purposes and is thus a taxpayer that may be liable to tax on its income. Generally speaking, a trust is taxed insofar as the income is not taxed in the hands of the beneficiary. This outcome is achieved by allowing the trust to deduct income taxed in the beneficiary's hands. The beneficiary is then taxed on income payable to the beneficiary and deducted by the trust. Generally, income does not retain its nature when it is passed on through a trust to a beneficiary, although there are important exceptions to this rule. Under certain circumstances, the income is not taxed in the hands of the trust or the beneficiary, but is attributed to and taxed in the hands of the settlor.

3.5 The Netherlands

3.5.1 Introduction

Until 2010, there was little or no legislation involving the taxation of trusts in the Netherlands. Case law and policy statements by the authorities determined the taxation of the relevant parties to the trust. Taxpayers were encouraged to reach an agreement with the tax authorities on all the tax issues in advance.⁶⁷³ However, in 2010, legislation which aims to govern the taxation of trusts entered into force.⁶⁷⁴ Trusts, especially discretionary trusts, were seen as abusive⁶⁷⁵ and the legislation was an attempt to address this abuse. This legislation is discussed below.

⁶⁶⁹ That is, income earned by a non-resident who is employed in Canada, carries on business in Canada or who disposes of taxable Canadian property. Permissible expenses and deductions may be deducted in calculating the income. (Brown in *Topical Analysis* para 4.1.1.).

⁶⁷⁰ Brown in *Topical Analysis* paras 4.1.1 and 4.3.1.

⁶⁷¹ Brown in *Topical Analysis* para 4.3.2.2.

⁶⁷² Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 78.

⁶⁷³ Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 224; Wheeler (2011) 3 *World Tax Journal* 39 65.

⁶⁷⁴ *Wet inkomstenbelasting 2001* s 2.14a.

⁶⁷⁵ Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 251.

3.5.2 *Afgezonderd particulier vermogen*

The legislation introduces the concept of an *afgezonderd particulier vermogen* (APV), translated as *separated private property*,⁶⁷⁶ *separate private fund*,⁶⁷⁷ or *separated private assets*.⁶⁷⁸ Wheeler describes an APV as follows:

“[I]t has a private aim that is more than incidental; the separation of the fund is not carried out in exchange for the issue of any shares, profit shares, membership rights, shared entitlement or comparable rights; and the separation of the fund does not give any shared economic entitlement. The separation of assets into such a fund is defined as: separating assets in such a fund for no consideration or on abnormal conditions; or transferring assets to such a fund that has a private aim that is more than incidental and that is a private aim of the transferor or defined family members of the transferor.”⁶⁷⁹

Clearly, companies with a share capital, mutual funds and partnerships are not covered by this definition.⁶⁸⁰ However, the rest of the definition is vague. It is, for example, unclear what the term private (in “private purpose”) means. According to Auerbach it refers to “a limited group of people, usually a family”.⁶⁸¹ He further asserts that the words “more than inessentially” mean more than ten to fifteen per cent, but that it is unclear how this percentage should be measured. Some authors are of the view that the definition was deliberately left equivocal in order to accommodate hybrid arrangements and other entities that will be developed in future.⁶⁸² It has been asserted that, in determining its status as an APV, it is irrelevant whether an entity has juristic personality or not.⁶⁸³

Authors agree that irrevocable discretionary trusts will be regarded as APVs.⁶⁸⁴ However, some doubt whether fixed (or vesting) trusts will be regarded as APVs, because such trusts

⁶⁷⁶ Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 250.

⁶⁷⁷ Wheeler (2011) 3 *World Tax Journal* 39 65.

⁶⁷⁸ Boer *De Anglo-Amerikaanse trust in de inkomsten- en vennootschapsbelasting* 413.

⁶⁷⁹ Wheeler (2011) 3 *World Tax Journal* 39 65. Auerbach translates the definition as follows: “[A]n entity, with or without legal personality, that more than inessentially serves a private purpose, unless against the separation of property (a) shares, jouissance rights, membership rights, certificates of joint entitlement or similar rights were issued, or (b) a joint economic entitlement was created” (Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 251). The definition is contained in the *Wet inkomstenbelasting 2001* s 2.14a para 2 and reads as follows: “[E]en afgezonderd vermogen waarmee meer dan bijkomstig een particulier belang wordt beoogd, tenzij tegenover de afzondering van dit vermogen: a. een uitreiking van aandelen, winstbewijzen, lidmaatschapsrechten, bewijzen van deelgerechtigdheid of daarmee vergelijkbare rechten heeft plaatsgevonden, of b. een economische deelgerechtigdheid is ontstaan”.

⁶⁸⁰ Also, if “een stichting toch als algemeen nut beogende instelling kan worden aangemerkt”, it will not be regarded as an APV in terms of regulation (Bresser *Belastingplicht voor de Vennootschapsbelasting van Stichtingen en Verenigingen* 129).

⁶⁸¹ Support for this view may be found in Heithuis *et al Inkomstenbelasting alsmede Hoofdzaken Loonbelasting* 66.

⁶⁸² Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 252; Heithuis *et al Inkomstenbelasting alsmede Hoofdzaken Loonbelasting* 66 and Bresser *Belastingplicht voor de Vennootschapsbelasting van Stichtingen en Verenigingen* 128.

⁶⁸³ Heithuis *et al Inkomstenbelasting alsmede Hoofdzaken Loonbelasting* 66.

⁶⁸⁴ Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 251; Wheeler (2011) 3 *World Tax Journal* 39 65; Boer and Freudenthal (2009) June *WPNR* 507 508; Roelofs (2010) 6887 *Weekblad Fiscaal Recht* 1632 1636.

would constitute shared economic entitlements (*economische deelgerechtigtheid*).⁶⁸⁵ If this view is correct, it would mean that fixed trusts would still be governed by the position prior to the introduction of the relevant legislation.⁶⁸⁶

If a trust is regarded as an APV, the implication is that the income, expenses, assets and liabilities of the APV are attributed back to the contributor for income tax purposes.⁶⁸⁷ Typically, the settlor of a trust will also be the contributor for purposes of an APV, but this is not necessarily so.⁶⁸⁸ Upon the contributor's death, the income is attributed to his or her heirs (in terms of the will or the rules of intestate succession) in proportion to their entitlements to the contributor's estate. On an heir's death, the attribution is made proportionally to his or her heirs and so the process continues.⁶⁸⁹ In order to prevent the possible avoidance of the legislation, heirs who were disinherited, but who are still beneficiaries of the APV, are treated as heirs for attribution purposes.⁶⁹⁰ Nevertheless, if an heir is not and cannot become a beneficiary of the APV, the attribution of income will not apply to him or her.⁶⁹¹ If there are both fixed (or vested) beneficiaries and discretionary beneficiaries in a trust, Auerbach contends that the APV legislation (and therefore attribution to the contributor) will only apply to the "discretionary part" of the trust.⁶⁹² If there is more than one contributor, he argues that the attribution will take place "on a pro rata basis".⁶⁹³

3.5.3 The APV legislation is not applicable

If a trust is not regarded as an APV, the trustee cannot be taxed in relation to the trust assets as the trustee lacks any economic interest.⁶⁹⁴

⁶⁸⁵ Boer and Freudenthal (2009) June *WPNR* 507 508; Roelofs (2010) 6887 *Weekblad Fiscaal Recht* 1632 1635.

⁶⁸⁶ Roelofs (2010) 6887 *Weekblad Fiscaal Recht* 1632 1635.

⁶⁸⁷ *Wet inkomstenbelasting* 2001 s 2.14a para 1. An exception applies if the trust carries on a business and is subject to tax on its net profit at at least ten per cent (*Wet inkomstenbelasting* 2001 s 2.14a para 7 Wheeler (2011) 3 *World Tax Journal* 39 65; Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 253; Boer *De Anglo-Amerikaanse trust in de inkomsten- en vennootschapsbelasting* 376).

⁶⁸⁸ Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 252; Wheeler (2011) 3 *World Tax Journal* 39 65; Heithuis *et al Inkomstenbelasting alsmede Hoofdzaken Loonbelasting* 68 and Boer *De Anglo-Amerikaanse trust in de inkomsten- en vennootschapsbelasting* 413.

⁶⁸⁹ *Wet inkomstenbelasting* 2001 s 2.14a para 1; Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 252; Wheeler (2011) 3 *World Tax Journal* 39 65 and Heithuis *et al Inkomstenbelasting alsmede Hoofdzaken Loonbelasting* 69. If, however, the contributor, his or her partner, or heirs cannot be identified, the income will be attributed to the beneficiary of the APV (*Wet inkomstenbelasting* 2001 s 2.14a para 5; Wheeler (2011) 3 *World Tax Journal* 39 65; Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 252–253).

⁶⁹⁰ *Wet inkomstenbelasting* 2001 s 2.14a para 4; Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 252 and Heithuis *et al Inkomstenbelasting alsmede Hoofdzaken Loonbelasting* 70.

⁶⁹¹ *Wet inkomstenbelasting* 2001 s 2.14a para 6; Wheeler (2011) 3 *World Tax Journal* 39 65; Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 253 and Heithuis *et al Inkomstenbelasting alsmede Hoofdzaken Loonbelasting* 69.

⁶⁹² See also Heithuis *et al Inkomstenbelasting alsmede Hoofdzaken Loonbelasting* 68.

⁶⁹³ Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 252.

⁶⁹⁴ Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 242–243; Wheeler (2011) 3 *World Tax Journal* 39 64; Boer *De Anglo-Amerikaanse trust in de inkomsten- en vennootschapsbelasting* 313–314.

In terms of the *Wet op de vennootschapsbelasting*,⁶⁹⁵ the Dutch corporate income tax legislation, only certain listed entities that are resident in the Netherlands are subject to tax on their worldwide income. However, the trust does not fall within any of these entities and can, accordingly, not be subject to comprehensive corporate income tax.⁶⁹⁶ Some non-resident trusts will qualify as *doelvermogens* (purpose funds),⁶⁹⁷ which would mean that they will be subject to corporate income tax under the *Wet op de vennootschapsbelasting* 1969 in respect of certain of their Dutch income.⁶⁹⁸ A trust is not subject to personal income tax in terms of the *Wet inkomstenbelasting*.⁶⁹⁹

If the argument, that a fixed (or vesting) trust is not an APV, is correct, the beneficiaries of such a trust may be liable to tax. Should the payments be regarded as periodic payments, these payments may be taxed in either box one or box three.⁷⁰⁰ If the distribution represents a consideration for another payment, the value of the right to the distribution will fall in box three. If the periodic payment is not paid as consideration for another payment, it will be taxed in box one.⁷⁰¹ If the payment is not a periodic payment and the trustee is obliged to pay all the income of the trust to the beneficiary, it will not fall in box one and the beneficiary will be taxed as if he or she is a usufructuary of the trust assets.⁷⁰²

The settlor of a trust is, generally speaking, not subject to tax on the trust's income. If, however, a trust is regarded as transparent, the trust is disregarded and the assets are attributed directly to the settlor. The implication is that the settlor will be taxed on the income as if these assets were his or hers. A revocable trust is an example of a trust that may be regarded as transparent, although the facts of each case should be considered carefully as some revocable trusts will not be regarded as transparent. In the case of irrevocable trusts, the trust assets will not be attributed to the settlor, unless the trust is regarded as transparent (for example, if the settlor is also the trustee).⁷⁰³

⁶⁹⁵ *Wet op de vennootschapsbelasting* 1969.

⁶⁹⁶ Boer *De Anglo-Amerikaanse trust in de inkomsten- en vennootschapsbelasting* 303–306; Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 243. Both these authors mention the business trust as a possible exception to this statement, but only if the business trust is regarded as a juristic person. Therefore, if a trust is regarded as a juristic person, it will qualify as one of the listed entities and could be liable to corporate income tax if it is also regarded as a resident in the Netherlands. Since business trusts fall outside the scope of this dissertation, the point will not be further considered, save to mention that in none of the jurisdictions studied in this dissertation is a business trust regarded as a juristic person (see ch 2.7).

⁶⁹⁷ The term *doelvermogen* is not defined in the *Wet op de vennootschapsbelasting* 1969 and its exact content is uncertain. The Anglo American trust has been described as the standard example of an entity that would qualify as a *doelvermogen* (Stevens *Belastingplicht in de Vennootschapsbelasting* 149; Boer *De Anglo-Amerikaanse trust in de inkomsten- en vennootschapsbelasting* 307).

⁶⁹⁸ *Wet op de vennootschapsbelasting* 1969 s 3; Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 244; Te Spenke and De Vries *Taxation in the Netherlands* 41; Pijl in *Cahiers de Droit Fiscal International: Conflicts in the Attribution of Income to a Person* 460.

⁶⁹⁹ *Wet inkomstenbelasting* 2001.

⁷⁰⁰ Personal income tax is levied in terms of the *Wet inkomstenbelasting* 2001, which uses three different boxes into which income is classified.

⁷⁰¹ Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 246. See also Roelofs (2010) 6887 *Weekblad Fiscaal Recht* 1632 1634.

⁷⁰² Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 246.

⁷⁰³ Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 244–245.

3.5.4 Conclusion

The entry into force of the APV regime has marked an enormous change in the way that a trust and the parties thereto are taxed in the Netherlands. The effect of the APV legislation is that the settlor of the trust will almost always be taxed on the trust income. Although there is some debate regarding the meaning of the term APV, it is reasonably clear that a discretionary trust will be regarded as an APV. Consequently, the income of a discretionary trust will usually be attributed to the settlor and taxed in his or her hands. Some argue that a fixed trust cannot be regarded as an APV. If this view is correct and the APV regime is not applicable, the (uncertain) position prior to the introduction of the APV legislation will prevail.

3.6 Conclusion

All of the states under discussion in this dissertation have the same broad policy aim, namely that income passing through a trust is taxed only once. These states use different mechanisms to achieve this aim, with South Africa following the initial choice system, the United Kingdom following the credit system, Canada following the deduction system and the Netherlands following a system of attributing trust income to the settlor. It may also be noted that all of the states address tax avoidance through the use of trusts, a point which will be reverted to below.

In both South Africa and Canada, the trust itself may be a taxpayer. The position in the United Kingdom is different, where the trustees are viewed as if they were a single person, distinct from the persons who are the trustees of the trust. Thus, the trustee is regarded as the taxpayer and not the trust itself. In the Netherlands, the trust or the trustee is not taxed if the APV regime applies. If it does not, neither the trust nor the trustee will, generally, be taxed.

In the United Kingdom and in Canada, the trust income is included in the trustee's (United Kingdom) or the trust's (Canada) income. In the case of Canada, the amount payable to the beneficiary is then deducted, whereas in the United Kingdom the beneficiary receives a credit for the tax paid by the trustee. In South Africa, if the beneficiary is liable to tax, no inclusion of the income in the trust's hands takes place and in the Netherlands, if the APV regime applies, the income is attributed to the settlor and the trust is not taxed. In all of these states, except for the Netherlands under the APV regime, the amount on which a beneficiary is to be taxed is included in his or her income. A further similarity between South Africa, the United Kingdom and Canada is that the distribution of accumulated income of a discretionary trust⁷⁰⁴ to the beneficiary is free of any income tax in the beneficiary's hands.

In South Africa, the United Kingdom and Canada, it is not a requirement that income in fact be paid to the beneficiary for it to be regarded as the beneficiary's income for tax purposes. As long as the beneficiary has an enforceable right to the income, it will be regarded as the beneficiary's income, irrespective of whether it has actually been paid to the beneficiary.

In South Africa income retains its nature (or character) as it flows through the trust and the trust is seen as a mere conduit. The position in the United Kingdom is different in respect of

⁷⁰⁴ That is, income that is not distributed to the beneficiary in the year in which the trust obtains the income.

discretionary trusts, where the trust is regarded as the source of the income and not the underlying assets. In the case of a fixed interest trust, the underlying assets (and not the trust itself) of an English law trust is regarded as the source of the income, but in respect of “Garland jurisdictions” the trust is seen as the source of the income. In principle, Canada deems income included in the hands of a beneficiary of a trust to be income from a trust. There are, however, a few important exceptions to this rule. It is submitted that all three of these jurisdictions feature the flow-through of the nature of the trust income to a greater or lesser extent.

As mentioned earlier, all of the states under discussion have rules intended on curbing tax avoidance through the use of trusts. All of these states attribute income of the trust to the settlor under certain circumstances.⁷⁰⁵ In the Netherlands, the income is almost invariably attributed to the settlor (although there is an exception to this rule). In South Africa, the United Kingdom and in Canada, income is attributed to the settlor if the trust is created for the benefit of a minor child or a spouse⁷⁰⁶ of the settlor or if the settlor retains a fair measure of control over the trust, for example by retaining the power to revoke the trust. In South Africa, if a resident settlor makes a donation settlement or other disposition to a non-resident trust which results in the trust receiving an amount which would have constituted income, had the trust been a resident, the income is attributed to the settlor. Broadly similar legislation is found in the United Kingdom in its transfer of assets abroad legislation, although the South African legislation may be wider in scope and is not limited “to situations in which the resident transferor can obtain any benefit from the income, nor is there any escape clause if the transferor can demonstrate that the transfer was not made for tax avoidance reasons”.⁷⁰⁷ In South Africa, income is also attributed to the settlor if, broadly speaking, the beneficiary’s receipt of the income is delayed until the happening of an event stipulated by the settlor.

A further point illustrating the anti-avoidance policy of all the states under discussion, is that they all tax trusts (or the trustee) at a very high tax rate, making a trust an unattractive vehicle from a tax perspective.

South Africa, the United Kingdom and the Netherlands furthermore have provisions dealing with non-resident trusts and non-resident beneficiaries. Broadly speaking, South Africa and the United Kingdom apply their usual rules to these trusts and beneficiaries, subject to the limitation that income must be from a source in that country to be taxable. However, both of these states also have specific rules relating to non-resident trusts (for example, sections 7(8) and 25B(2A) in South Africa) or non-resident beneficiaries (for example, a beneficiary that is not resident in the United Kingdom can only receive the tax credit if the trustee is resident in the United Kingdom). Broadly speaking, Canada employs a unique set of rules in respect of non-resident trusts.

In conclusion, there are many similarities regarding the taxation of trusts between the states considered in this dissertation. Given the similar policy considerations, these similarities are to be expected. However, there are also marked differences between the systems employed

⁷⁰⁵ Obviously the exact circumstances under which these provisions apply differ from state to state. Only the general trends are noted here.

⁷⁰⁶ In all three states the provisions cover not only married persons, but also partners.

⁷⁰⁷ Wheeler (2011) 3 *World Tax Journal* 247 275.

to achieve the policy. Given that each exercises its sovereignty in making its own tax laws, these differences are also predictable. As will become evident in the further chapters of this dissertation, these similarities and differences significantly influence the outcome of the application of the OECD MTC to a trust (and the other parties to the trust) by each of the relevant states.

CHAPTER 4

INTERPRETATION AND STATUS OF DOUBLE TAX TREATIES

Chapter overview	95
4.1 Introduction	96
4.2 Background to the OECD MTC	96
4.3 Interpretation of the OECD MTC	98
4.3.1 General points regarding the interpretation of DTTs	98
4.3.2 South Africa	101
4.3.2.1 The Constitution	101
4.3.2.2 Case law	102
4.3.3 United Kingdom	109
4.3.4 Canada	110
4.3.5 The Netherlands	110
4.4. Status of tax treaties	111
4.4.1 South Africa	111
4.4.2 United Kingdom	120
4.4.3 Canada and the Netherlands	121
4.5 Conclusion	121

4.1 Introduction

This chapter will discuss the interpretation and status of double taxation treaties (DTT)⁷⁰⁸ in each of the relevant states. The purpose of this chapter is to create a backdrop for the further chapters of this dissertation, in which the relevant provisions of the Organisation for Economic Co-operation and Development Model Tax Convention (OECD MTC) will be analysed to determine how trusts are to be treated in terms of the OECD MTC. Without this vital backdrop, the references to the OECD MTC, its commentary and reports in later chapters may not be appreciated. Also, the influence of interpretation and status accorded to its treaties in relation to other legislation in each state will become apparent in later chapters.

This aim of providing the required backdrop is achieved by sketching, briefly, the background to the OECD and its model tax convention. After making certain general points regarding the interpretation of treaties, each of the relevant countries' approach to treaty interpretation will be discussed. Lastly, the status of DTTs in each of the states will be addressed. Throughout this chapter the emphasis will fall on the South African position.⁷⁰⁹

4.2 Background to the OECD MTC

The Organisation for Economic Co-operation and Development (OECD) was formed in 1961. Its predecessor, the Organisation for European Economic Cooperation (OEEC), was created in order to manage the Marshall plan, which was financed by the United States of America (USA) to rebuild Europe after the Second World War. When the USA and Canada joined the OEEC, the OECD was formed. Currently there are 34 member countries,⁷¹⁰ including the United Kingdom, Canada and the Netherlands.⁷¹¹ Although South Africa is not a member of the OECD, it is part of the Enhanced Engagement proposal, which means that South Africa participates in some of the OECD's activities, such as regular economic surveys.⁷¹² South Africa is also part of the group of non-OECD member countries whose positions on the OECD MTC are set forth in a section to the OECD MTC.⁷¹³

Decisions of the OECD are taken by consensus by its Council and are binding on member countries. Recommendations, which are also made by consensus by the Council, are not

⁷⁰⁸ This part of the dissertation draws on the research contained in an earlier article (Du Plessis (2012) 24 *SA Merc LJ* 31).

⁷⁰⁹ The reasons for this emphasis are twofold. Firstly, the dissertation is written from a South African perspective and, secondly, there is limited literature available on this topic in South Africa.

⁷¹⁰ OECD "History"

<http://www.oecd.org/document/25/0,3746,en_36734052_36761863_36952473_1_1_1_1,00.html> (accessed on 27/05/2011).

⁷¹¹ OECD "Members and Partners"

<http://www.oecd.org/pages/0,3417,en_36734052_36761800_1_1_1_1_1,00.html> (accessed on 27/05/2011).

⁷¹² OECD "Enhanced Engagement"

<http://www.oecd.org/document/36/0,3746,en_2649_201185_41668772_1_1_1_1,00.html> (accessed on 27/05/2011).

⁷¹³ South Africa has observer status, meaning that South Africa's views (that is the parts of the OECD MTC and Commentary with which South Africa agrees or disagrees) are published separately by the OECD (Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 159)..

binding.⁷¹⁴ Specialised committees are formed to work on specific policy areas.⁷¹⁵ One of them is the Committee on Fiscal Affairs (CFA), which has several working parties.⁷¹⁶ After consensus is reached within a working party, it makes recommendations to the CFA and, if approved, these are forwarded to the Council for adoption.⁷¹⁷

The OECD has published a number of model tax conventions and draft model tax conventions, including the loose-leaf OECD MTC, which was first published in 1992. This model convention is updated every two to three years.⁷¹⁸ The last update, and the one on which this dissertation is based, was approved by the OECD Council in July 2010.⁷¹⁹ Each model tax convention is accompanied by commentary drafted by the CFA.⁷²⁰ Member countries of the OECD may enter reservations to the articles of the OECD MTC in order to preserve their freedom to depart from the OECD MTC. They may also enter observations to the commentary to indicate how they will apply the provisions of a particular article.⁷²¹

Although the OECD MTC is not an international treaty and therefore not binding on the OECD member states, its influence has been widely acknowledged. Both members and non-members of the OECD use the OECD MTC as a basis for negotiating DTTs⁷²² and the vast majority of treaties entered into used the OECD MTC as basis.⁷²³ Indeed, the OECD MTC has been described as the “keystone of the tax treaty system”.⁷²⁴

⁷¹⁴ Ward (2006) 60 *BFIT* 97 97.

⁷¹⁵ OECD "Who does What?"

<http://www.oecd.org/pages/0,3417,en_36734052_36761791_1_1_1_1_1,00.html> (accessed on 27/05/2011).

⁷¹⁶ Ward *et al* *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries of the OECD Model 9*; Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para A.01.

⁷¹⁷ Ward *et al* *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries of the OECD Model 11*; Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para A.04.

⁷¹⁸ Ward *et al* *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries of the OECD Model 7–8*; Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 158; Panayi *Double Taxation, Tax treaties, Treaty-shopping and the European Community* 25; Olivier and Honiball *International Tax: a South African Perspective* 268.

⁷¹⁹ OECD "OECD approves the 2010 Update to the OECD Model Tax Convention" <http://www.oecd.org/document/32/0,3746,en_2649_33747_45689952_1_1_1_1,00.html> (accessed on 27/05/2011).

⁷²⁰ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para A.06; Ward (2006) 60 *BFIT* 97 97.

⁷²¹ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para A.08.

⁷²² Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para A.07; OECD *Introduction to OECD Model Tax Convention on Income and on Capital* para 13–14; Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 157; Panayi *Double Taxation, Tax treaties, Treaty-shopping and the European Community* 25.

⁷²³ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para A.11; Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 159.

⁷²⁴ Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 159.

4.3 Interpretation of the OECD MTC⁷²⁵

In this paragraph, general comments will be made regarding the interpretation of DTTs (the OECD MTC). Thereafter, the interpretation of treaties in each of the relevant states will be discussed.

4.3.1 General points regarding the interpretation of DTTs

Any DTT has a dual nature: firstly, it is an international agreement entered into between two states (that is, a bilateral agreement) and, secondly, it becomes part of domestic law. As an international agreement, it is subject to the rules of interpretation of other treaties, in other words, public international law, but as domestic law it is subject to the rules applicable to domestic legislation.⁷²⁶

Under public international law, the treaty is to be given an autonomous meaning (that is, the meaning of the treaty irrespective of the domestic law of the relevant states).⁷²⁷ In terms of public international law, the Vienna Convention on the Law of Treaties (Vienna Convention)⁷²⁸ contains rules regarding the interpretation of treaties.⁷²⁹ Canada, the United Kingdom and the Netherlands have ratified the Vienna Convention.⁷³⁰ Even though South Africa has not ratified the Vienna Convention, most authors agree that South Africa is, generally speaking, bound by the provisions of the Vienna Convention, as it is merely a codification of customary international law.⁷³¹ However, in *Harksen v President of the Republic of South Africa*⁷³² the Constitutional Court stated that the extent to which the Vienna Convention reflects customary international law is by no means settled. Yet it assumed that a particular provision of the Vienna Convention did reflect customary international law and, therefore, formed part of South African law. The point has been made that although the court cast doubt on whether the Vienna Convention reflects customary international law, articles 32 and 31, dealing with the interpretation of treaties, are generally

⁷²⁵ The topic of the interpretation of DTTs is very extensive and literature on the topic abounds. This dissertation will not attempt to discuss the interpretation of DTTs comprehensively. Rather, the most important issues will be highlighted. Art 3(2) of the OECD MTC is discussed in ch 5 of this dissertation. Other specific points regarding the interpretation of treaties will be addressed in later chapters as they crop up.

⁷²⁶ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para E.02; Schwarz *Schwarz on Tax Treaties* para 12–000; Avery Jones (2001) 55 *BFIT* 220 222.

⁷²⁷ *R v Secretary of State for the Home Department ex parte Adan* [2001] 2 WLR 143; Avery Jones (2001) 55 *BFIT* 220 222.

⁷²⁸ Vienna Convention on the Law of Treaties 1969.

⁷²⁹ Not all authors agree that the Vienna Convention is useful when it comes to the interpretation of treaties. According to Arnold “the provisions of the Vienna Convention dealing with the interpretation of tax treaties are largely meaningless. Art. 31 is so vague and general and selfevident that it cannot provide any real guidance for – or control over – the interpretive process. Art. 32, which appears to be more rule-like, is equally meaningless because it allows reference to supplementary materials in all instances, but then attempts to limit the use (but not the weight) of such material. It is not surprising then that Arts. 31 and 32 of the Vienna Convention do not appear to have had any practical effect on the interpretation of tax treaties in actual cases” (Arnold (2010) 64 *BFIT* 1 8). This view is shared by Ward (Ward (2006) 60 *BFIT* 97 98).

⁷³⁰ Anonymous “Trade Treaties International Conventions” <<http://www.jurisint.org/en/ins/421.html>> (accessed on 31/05/2011).

⁷³¹ Scholtz (2004) 29 *SAYIL* 202 207; Olivier and Honiball *International Tax: a South African Perspective* 308; Dugard *International Law: a South African Perspective* 414.

⁷³² *Harksen v President of the Republic of South Africa* 2000 2 SA 825 (CC).

accepted as correctly indicating customary international law.⁷³³ In *Glenister v President of the Republic of South Africa* the majority of the court relied on art 31(3)(b) of the Vienna Convention, stating that “the subsequent practice of states in applying a treaty can be used to indicate how the states have interpreted the treaty and thus give content to treaty obligations”.⁷³⁴ The minority also quoted with approval from the Vienna Convention.⁷³⁵ The Constitutional Court’s reliance on the Vienna Convention adds weight to the view that the Vienna Convention forms part of South African law. Interestingly, the Court of Appeal in the United Kingdom is of the view that South Africa is bound to articles 31 and 32 of the Vienna Convention even though South Africa is not a party to the Vienna Convention.⁷³⁶

The point of departure when considering the Vienna Convention is article 26, which states that treaties are binding upon the parties to it and must be performed by them in good faith. Articles 31 and 32 of the Vienna Convention then provide as follows:

“Article 31

General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
 - (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
 - (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
 - (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
 - (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
 - (c) any relevant rules of international law applicable in the relations between the parties.
4. A special meaning shall be given to a term if it is established that the parties so intended.

⁷³³ West *The Taxation of International (non-resident) Sportspersons in South Africa* 24–25.

⁷³⁴ *Glenister v President of the Republic of South Africa* 2011 3 SA 347 (CC) para 187 and fn 43.

⁷³⁵ *Glenister v President of the Republic of South Africa* 2011 3 SA 347 (CC) para 91.

⁷³⁶ *Ben Nevis (Holdings) Ltd v Her Majesty’s Revenue and Customs* [2013] EWCA Civ 578 para 17 where the court stated that “[t]he rules of interpretation set out in Articles 31 and 32 of the Vienna Convention are rules of customary international law and therefore binding on all States regardless of whether or not they are parties to that Convention”.

Article 32

Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

- (a) leaves the meaning ambiguous or obscure; or
- (b) leads to a result which is manifestly absurd or unreasonable.”

The general trend amongst courts in various countries is to apply the rules of public international law to interpret DTTs and not the normal rules for the interpretation of domestic legislation.⁷³⁷ Article 31(1) of the Vienna Convention specifically refers to the ordinary meaning of a term. In this regard the ordinary meaning has been described as “the meaning that naturally flows from a reading of the text considering its object and purpose and taking into account the common intention of the parties. This refers to the way that a specific term would be understood in that particular context”.⁷³⁸

As stated in the relevant articles of the Vienna Convention, courts may also use extrinsic aids⁷³⁹ to interpret a DTT, one of which is the OECD Commentary to the OECD MTC.⁷⁴⁰ Although there are several categories of material mentioned in articles 31 and 32 of the Vienna Convention in which the Commentary may be classed in order to provide a basis for their use in the interpretation of a DTT, the Commentary does not fit neatly into any of these categories. Furthermore, academic writers do not agree on the category in which the Commentary should be placed.⁷⁴¹

Despite this uncertainty, the courts in many countries use the OECD Commentary in the interpretation of treaties,⁷⁴² but the exact basis on which they do so is unclear and not

⁷³⁷ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para E.02; Brincker in *Silke on International Tax* para 12.8.1. Arnold argues that DTTs should not be interpreted differently from domestic legislation. He provides a number of reasons usually given for the differences in interpretation, but argues that these differences, although real, do not justify different interpretational approaches (Arnold (2010) 64 *BFIT* 1 9–12).

⁷³⁸ Sada Garibay (2011) 65 *An Analysis of the Case Law on Article 3(2) of the OECD Model (2010)* .

⁷³⁹ Examples of extrinsic aids include the OECD MTC, its Commentary, travaux préparatoires and unilateral material. (Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para E.09.)

⁷⁴⁰ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para E.09.

⁷⁴¹ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para E.12. According to Baker the possible categories are “Article 31(1): material establishing the ordinary meaning to be given to terms of the treaty; Article 31(2): as part of the context of the treaty, an agreement made between all the parties in connection with the conclusion of the treaty, or an instrument made by one or more parties and accepted by the other parties; Article 31(3) a subsequent agreement or subsequent practice regarding the interpretation of the treaty; Article 31(4) material establishing a special meaning to be given to terms in the treaty; Article 32: as a supplementary means of interpretation, including the preparatory work of the treaty.” See also Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 164.

⁷⁴² Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para E.10; OECD *Introduction to OECD Model Tax Convention on Income and on Capital* para 29.1; *Crown Forest Industries Ltd v The Queen* [1995] 2 SCR 802.

frequently explicitly stated by the courts.⁷⁴³ The OECD itself certainly intended that the Commentary be used in the interpretation of DTTs.⁷⁴⁴ The OECD Commentary are not considered binding rules of international law.⁷⁴⁵ Thus, although neither the OECD MTC nor its Commentary is legally binding on the courts, the courts often place significant weight on the Commentary, although the basis on which this is done is not always clear.

A further point of uncertainty regarding the use of the Commentary is the version of the Commentary to be used. If a DTT was concluded in a given year and the OECD subsequently changed the Commentary, which Commentary is to be used when a dispute arises? The OECD's view is that existing treaties should be interpreted in the spirit of the revised Commentary, as far as possible.⁷⁴⁶ The OECD concedes that if the revised articles or Commentary in substance differ from those used in previously concluded treaties, the revised Commentary are irrelevant.⁷⁴⁷ The OECD's view that the latest version of the Commentary should be used is not shared by all.⁷⁴⁸

4.3.2 South Africa

4.3.2.1 The Constitution⁷⁴⁹

The Constitution provides that customary international law is law in the Republic unless it is inconsistent with the Constitution or an act of Parliament.⁷⁵⁰ Thus customary international law forms part of South Africa's domestic law and can only be trumped by an act of Parliament or the Constitution. A South African court may take judicial notice of customary international law, which, in practice, would mean the consideration of judicial decisions, both foreign and South African, and international law treaties.⁷⁵¹ A court would consider

⁷⁴³ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para E.12; Arnold (2010) 64 *BFIT* 1 8; Mössner (2010) 64 *BFIT* 16 ; Ward *et al The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries of the OECD Model* 31; Erasmus-Koen and Douma (2007) 61 *BFIT* 339 349; Harris and Oliver *International Commercial Tax* 34.

⁷⁴⁴ OECD *Introduction to OECD Model Tax Convention on Income and on Capital* para 29, although the OECD does not consider the Commentary as binding. The OECD has also made a non-binding recommendation that the OECD members follow the Commentary (Ward (2006) 60 *BFIT* 97 99; Engelen (2006) 60 *BFID* 105 105).

⁷⁴⁵ Ward *et al The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries of the OECD Model* 52. A contrary view is held by Engelen (Engelen (2006) 60 *BFID* 105 106–109). Some authors have described the Commentary as “soft law” (eg Vogel *et al Klaus Vogel on Double Taxation Conventions* 45), although Ward *et al* are of the opinion that “attaching the description ‘soft law’ to the commentaries does not give the commentaries any status or position in international law that they would not have had in the absence of such a descriptive and somewhat ambiguous label” (Ward *et al The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries of the OECD Model* 38).

⁷⁴⁶ OECD *Introduction to OECD Model Tax Convention on Income and on Capital* para 33.

⁷⁴⁷ OECD *Introduction to OECD Model Tax Convention on Income and on Capital* paras 33–35.

⁷⁴⁸ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para E.13; Vogel *et al Klaus Vogel on Double Taxation Conventions* 46; Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 167. For an overview of the approaches followed by courts in a number of countries as well as the views of academic authors, see Ward *et al The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries of the OECD Model* 95–110.

⁷⁴⁹ Generally speaking the pre-1996 constitutional position will not be discussed. Treaties entered into by South Africa prior to the Constitution is regarded as binding on the country in terms of s 231(5) of the Constitution of the Republic of South Africa 1996.

⁷⁵⁰ Constitution of the Republic of South Africa 1996 s 232.

⁷⁵¹ Dugard *International Law: a South African Perspective* 51.

these sources for guidance as to whether or not a particular rule is accepted as a rule of customary international law. As stated above, the Vienna Convention is considered to be a codification of customary international law and therefore forms part of South African law.⁷⁵² On the view that the OECD MTC and its Commentary are not international law, these will not form part of South African domestic law.⁷⁵³

Futhermore, the Constitution provides that when interpreting any legislation, every court must prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law.⁷⁵⁴ On the basis that the OECD MTC and its Commentary are not international law, South African courts will not be obliged to interpret the Income Tax Act⁷⁵⁵ in a way that is consistent with the OECD MTC and its Commentary.

4.3.2.2 Case law

In the next paragraphs the limited South African case law on the interpretation of treaties will be discussed with a view to drawing a conclusion regarding South Africa's approach to treaty interpretation. Reference will firstly be made to cases in which non-taxation treaties were interpreted and thereafter selected cases in which DTTs were interpreted, will be discussed.

In *Mzeku v Volkswagen SA (Pty) Ltd*⁷⁵⁶ the Labour Appeal Court was requested to find that certain employees had a right to strike based on the relevant provisions of International Labour Organisation (ILO) Convention 87 on Freedom of Association and the Right to Organise and ILO Convention 98 on the Right to Organise and Collective Bargaining. It was submitted that these conventions formed part of South African law based on sections 231 and 233 of the Constitution. It is submitted that the court made no finding regarding the basis on which the relevant ILO conventions formed part of South African law, but from the judgement it seems as if the court assumed that it was bound by these conventions. In interpreting the conventions, the court relied on an ILO report to the International Labour Conference by the Committee of Experts, unfortunately again without providing a basis for its reliance.⁷⁵⁷

In *Seton CO v Silveroak Industries Ltd*⁷⁵⁸ the court had to interpret the Recognition and Enforcement of Foreign Arbitral Awards Act,⁷⁵⁹ which was promulgated because South Africa was a party to the "New York Convention". The court, basing its finding on section 233 of the Constitution, held that the decisions of other countries, which also incorporated the provisions of the convention into their national legislation, had persuasive authority.

⁷⁵² Constitution of the Republic of South Africa s 232.

⁷⁵³ For a contrary view see Olivier and Honiball *International Tax: a South African Perspective* 312, who argue that the Commentary on the OECD MTC probably forms part of South Africa's customary international law.

⁷⁵⁴ Constitution of the Republic of South Africa s 233.

⁷⁵⁵ Income Tax Act 58 of 1962.

⁷⁵⁶ *Mzeku v Volkswagen SA (Pty) Ltd* 2001 4 SA 1009 (LAC).

⁷⁵⁷ *Mzeku v Volkswagen SA (Pty) Ltd* 2001 4 SA 1009 (LAC) paras 21–27.

⁷⁵⁸ *Seton Co v Silveroak Industries Ltd* 2000 2 SA 215 (T).

⁷⁵⁹ Recognition and Enforcement of Foreign Arbitral Awards Act 40 of 1977.

In *S v H*⁷⁶⁰ the court had to interpret the Hague Convention on the Civil Aspects of International Child Abduction (1980). The court referred to numerous foreign judgements and also to what it termed “Hague Convention jurisprudence in a number of international jurisdictions”.⁷⁶¹ The court furthermore quoted with approval a decision in which the House of Lords held that a purposive construction had to be given to the relevant convention.⁷⁶² Furthermore, the court adopted a test which “gives effect to the spirit of the convention”.⁷⁶³

In *Secretary for Inland Revenue v Downing*⁷⁶⁴ the court was called upon to interpret a provision in the DTT between South Africa and Switzerland. The treaty was based on the 1963 OECD MTC and was domesticated by virtue of section 108(2) of the Income Tax Act and therefore it was held by the court to have effect as if enacted into the Income Tax Act.⁷⁶⁵ The court acknowledged the widespread use of the OECD MTC by stating that:

“This model has served as the basis for the veritable network of double taxation conventions existing between this country and other countries and between many other countries *inter se*.”⁷⁶⁶

The court also observed that the DTT makes liberal use of what has been termed “international tax language”.⁷⁶⁷ The court *a quo* in *Downing* clearly referred to a certain passage in the OECD Report as part of its judgement. The Appellate Division quoted, with approval, the relevant part of the court *a quo*’s judgement in which it referred to the OECD Report.⁷⁶⁸ The Katz Commission regarded this part of the Appellate Division’s judgement as acknowledging the OECD’s commentary as an “important guide in interpreting concepts used in South African double taxation agreements,”⁷⁶⁹ a sentiment acknowledged by numerous authors.⁷⁷⁰

Furthermore, the court in *Downing* preferred to interpret certain words in their “natural meaning”. It referred to the intention of the parties to the treaty and concluded that the article should be read as a whole in order to interpret it.⁷⁷¹

A clause in the DTT between South Africa and Germany was the focus of the court’s attention in *ITC 1473*.⁷⁷² Without providing any grounds for doing so, the court, in order to support its interpretation of the relevant provision, referred to a letter by the German Ministry of Finance to the South African authorities, which seems to reflect an agreement between the countries regarding the interpretation of the relevant article.

⁷⁶⁰ *S v H* 2007 3 SA 330 (C).

⁷⁶¹ *S v H* 2007 3 SA 330 (C) para 44.

⁷⁶² *S v H* 2007 3 SA 330 (C) para 45.

⁷⁶³ *S v H* 2007 3 SA 330 (C) para 49.

⁷⁶⁴ *Secretary for Inland Revenue v Downing* 1975 4 SA 518 (A).

⁷⁶⁵ *Secretary for Inland Revenue v Downing* 1975 4 SA 518 (A) 522–523.

⁷⁶⁶ *Secretary for Inland Revenue v Downing* 1975 4 SA 518 (A) 523.

⁷⁶⁷ *Secretary for Inland Revenue v Downing* 1975 4 SA 518 (A) 523.

⁷⁶⁸ *Secretary for Inland Revenue v Downing* 1975 4 SA 518 (A) 526.

⁷⁶⁹ Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa *5th Interim Report of the Commission of Inquiry into certain Aspects of the Tax Structure of South Africa - basing the South African Income Tax System on the Source or Residence Principle - Options and Recommendations* para 4.1.2.

⁷⁷⁰ Eg Olivier and Honiball *International Tax: a South African Perspective* 311.

⁷⁷¹ *Secretary for Inland Revenue v Downing* 1975 4 SA 518 (A) 528.

⁷⁷² *ITC 1473* 1989 52 SATC 128 (C) 132.

In *ITC 1503*⁷⁷³ the court had to interpret an article in a treaty between South Africa and another country (its name not being mentioned in the report) for the avoidance of double taxation on income and profits derived from sea or air transport. The court held that the meaning of the treaty had to be determined according to the principles governing the interpretation of contracts in South Africa. The court held that it was obliged to determine what the language of the document would ordinarily be understood to mean and considered the fact that the arrangements in the treaty have the effect as if enacted in the Income Tax Act by virtue of section 108(2), to be irrelevant.⁷⁷⁴ The taxpayer and the Commissioner agreed in the statement of facts that they were entitled to refer to the text and Commentary of the 1977 OECD Model agreement without any admissions being made as to the evidentiary value and subject to permission of the court.⁷⁷⁵ In its judgement the court relied on the Commentary to the OECD Model in support of its conclusion.⁷⁷⁶ No reasons were given for the reference to the Commentary, but it may be explained by the agreement reached between the parties.

In *ITC 1544*⁷⁷⁷ the court had to decide whether non-resident shareholders' tax (NRST) imposed by South Africa fell foul of the non-discrimination article in the treaty between South Africa and the Netherlands. NRST was levied on dividends paid, *inter alia*, to companies which were not South African companies. A South African company paid dividends to its shareholder, a Dutch company, and tried to reclaim the NRST previously paid. The Dutch company argued that NRST discriminated against it on the basis of nationality and that such discrimination was prohibited by the non-discrimination clause in the South Africa-Netherlands treaty. The court found that NRST was indeed discriminatory against the Dutch company.⁷⁷⁸ The relevant treaty was domesticated in terms of section 108(2) of the Income Tax Act and the court held that the effect of that section is

“[t]o grant statutory relief in certain circumstances where the South African Act imposes a tax, where the provisions of a double-tax Convention grants an immunity or exemption from such tax to persons governed by the Convention. Tax is not payable to the extent to which an immunity or exemption from tax is granted in terms of a binding double tax Convention which has been proclaimed and thus has statutory effect.”

The court held that, in the light of section 108 of the Income Tax Act, the non-discrimination provision in the treaty “governed” the relevant NRST provisions and that no NRST was therefore payable by the Dutch company. It is submitted that the court therefore found that the provisions of a DTT had the effect of limiting the tax imposed by a previously enacted section of the Income Tax Act.

The DTT between South Africa and the United Kingdom was interpreted in *ITC 1735*.⁷⁷⁹ The court confirmed that the treaty had effect as if enacted in the Income Tax Act by reason of

⁷⁷³ *ITC 1503* 1990 53 SATC 342 (T).

⁷⁷⁴ *ITC 1503* 1990 53 SATC 342 (T) 347.

⁷⁷⁵ *ITC 1503* 1990 53 SATC 342 (T) 346.

⁷⁷⁶ *ITC 1503* 1990 53 SATC 342 (T) 348.

⁷⁷⁷ *ITC 1544* 1992 54 SATC 456 (T).

⁷⁷⁸ *ITC 1544* 1992 54 SATC 456 (T) 463.

⁷⁷⁹ *ITC 1735* 2002 64 SATC 455.

section 108(2). When interpreting the term “athlete” in the relevant treaty, the court attributed the “modern ordinary meaning” to the term and concluded that the parties could not have intended that a more impractical and limited meaning should apply. In determining what the “modern ordinary meaning” was, the court referred, *inter alia*, to the work by Vogel.⁷⁸⁰

In *AM Moolla Group Ltd v Commissioner for the South African Revenue Service*⁷⁸¹ the Supreme Court of Appeal had to interpret a provision in a trade treaty between South Africa and Malawi for the reduction of certain customs duties. The court relied on the provisions of the Customs and Excise Act,⁷⁸² which provides for the domestication of certain treaties, to conclude that the relevant treaty formed part of that Act. The court’s interpretation of the provisions of the treaty was based entirely on the fact that the treaty formed part of the Customs and Excise Act. Hence, it found that the meaning to be attached to a term used in the treaty, was the meaning ascribed to it in the relevant provision of the Customs and Excise Act (and regulations thereto) and not the ordinary meaning of the term. The court further held that, because the treaty formed part of the Customs and Excise Act and that, hence, the meaning of a term used in this Act was ascribed to the treaty, the interpretation of the treaty provisions must change when the Act is changed.

In *Volkswagen of South Africa (Pty) Ltd v Commissioner for the South African Revenue Service*⁷⁸³ the court had to decide whether Secondary Tax on Companies (STC), levied in terms of section 64B of the Income Tax Act, was a tax on dividends as provided for in article 7 of the DTT between South Africa and Germany and, in the alternative, whether STC was a tax substantially similar to taxes previously charged in South Africa (and explicitly mentioned in the particular DTT). The court did not refer to the OECD MTC or its Commentary in the judgement. This may be partly explained because article 7 of the relevant DTA specifically requires the law of the country where the company paying the dividend is resident to be applied. Hence the court, in deciding the first argument, was entitled – as it did – to have regard only to South African law.

*Grundlingh v Commissioner for the South African Revenue Service*⁷⁸⁴ afforded the court an opportunity to consider the treatment of partnerships under a DTT. The treatment of partnerships is dealt with in the OECD commentary and the OECD has also produced a comprehensive report on the matter.⁷⁸⁵ None of these sources were, regrettably, referred to by the court and the court therefore missed an opportunity, not only to comment on the legal status of the OECD Commentary and other materials,⁷⁸⁶ but also to gain assistance from these sources.⁷⁸⁷

In a case touching on the interpretation of treaties, handed down in June 2011 by the Western Cape High Court in the matter of *The Oceanic Trust Co Ltd NO v Commissioner for*

⁷⁸⁰ ITC 1735 2002 64 SATC 455 464.

⁷⁸¹ *AM Moolla Group Ltd v Commissioner for the South African Revenue Service* 2003 65 SATC 414.

⁷⁸² Customs and Excise Act 91 of 1964 s 1 (definition of “the Act”) and s 49(1)(a).

⁷⁸³ *Volkswagen of South Africa (Pty) Ltd v Commissioner for the South African Revenue Service* 70 SATC 195.

⁷⁸⁴ *Grundlingh v Commissioner for the South African Revenue Service* 2009 72 SATC 1.

⁷⁸⁵ Eg Commentary on the OECD MTC art 1 paras 2–6 and OECD *The Application of The OECD Model Tax Convention to Partnerships* (1999).

⁷⁸⁶ Hattingh (2010) 127 SALJ 38 45. This contribution also criticises the judgement on other points.

⁷⁸⁷ Brincker in *Silke on International Tax* para 12.8.8.

the South African Revenue Service,⁷⁸⁸ the applicant, a Mauritian company, was the sole trustee of a trust, known as SISM, which was established and registered in Mauritius. The court was called upon, *inter alia*, to issue a declaratory order to the effect that SISM was not a “resident” of South Africa and that it had not carried on business through a “permanent establishment” in South Africa. Not only were the relevant definitions in section 1 of the Income Tax Act relevant, but also the provisions of the DTT between South Africa and Mauritius, which included a definition of “resident”. It is important to note that although the South African Revenue Service’s (SARS) reasons for the assessment and the taxpayer’s (in other words the trustee’s) objection formed part of the papers in the application, the court was not asked to pronounce on the merits of either. The declaratory relief was aimed at establishing whether SISM was a “taxpayer”, which turned on the questions of whether it was a resident of South Africa or had conducted business through a permanent establishment. Much of the court’s judgement therefore focused on whether it had jurisdiction to grant the order prayed for. The court would only have jurisdiction if it had to decide a question of law and this was determined by whether the facts were fully found and sufficiently clear. In deciding this point in relation to the issue of residence, the court referred to the United Kingdom decision of *Smallwood*,⁷⁸⁹ but never referred to the OECD Commentary on article 4 (dealing with residence). Regarding the issue of permanent establishment, the court again did not refer to the OECD Commentary on the relevant article, even though there is Commentary pertinent to the points considered by the court. In neither of the two issues did the court refer to any international literature on the meaning of either of the relevant terms. Perhaps the court’s limited engagement with these issues may be explained if the nature of the relief prayed for is borne in mind, but given the fact that the court does make findings regarding residence and permanent establishment, its cursory consideration of these two important concepts is disappointing.

The latest case dealing with the interpretation of treaties was that of *Commissioner for the South African Revenue Service v Tradehold Ltd*.⁷⁹⁰ Tradehold was incorporated in South Africa and on 2 July 2002 its board, at a meeting in Luxembourg, took a decision that all future meetings of the board of directors would be held in Luxembourg. The court confirmed that with that decision Tradehold’s place of effective management was moved to Luxembourg.⁷⁹¹ At the relevant time the definition of resident⁷⁹² provided that Tradehold remained a resident of South Africa for domestic tax purposes, because it was incorporated in South Africa. It was only when this definition was amended that Tradehold ceased to be a resident of South Africa in terms of the Income Tax Act. SARS assessed Tradehold for a deemed disposal of certain assets when Tradehold ceased to be a resident (an “exit tax”). Tradehold argued, successfully, that the DTT between South Africa and Luxembourg prevented South Africa from taxing the relevant gain. Regarding the interpretation of the treaty, the court held that:

⁷⁸⁸ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127. This case will also be discussed in greater detail in ch 6 of this dissertation.

⁷⁸⁹ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778.

⁷⁹⁰ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA). This case is reverted to in ch 6.

⁷⁹¹ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 3.

⁷⁹² Income Tax Act 58 of 1962 s 1.

“The DTA is based upon the Model Tax Convention on Income and on Capital agreed to by the committee on Fiscal Affairs of the Organisation for European Economic Co-operation and Development (OECD), which has served as the basis for similar agreements that exist between many countries. In interpreting its provisions one must therefore not expect to find an exact correlation between the wording in the DTA and that used in the domestic taxing statute. Inevitably, they use wording of a wide nature, intended to encompass the various taxes generally found in the OECD member countries. In addition, because the double tax agreements are intended to encompass not only existing taxes, but also taxes which may come into existence at later dates (see Art 2(2)), and bearing in mind the complex nature of taxation in the various member countries, inevitably the wording in the DTA cannot be expected to match precisely that used in the domestic taxing statute. In *SIR v Downing supra* Corbett JA remarked at 523C-D:

‘The convention makes liberal use of what has been termed “international tax language” (see *Ostime (Inspector of Taxes) v Australian Mutual Provident Society*, 1960 AC 459 at p 480).’”

The court also adopted the approach of a United Kingdom court in interpreting a DTT, namely

“that the first step in any interpretive inquiry is to ascertain where in the scheme of the double tax agreement the relevant tax falls, and then to consider whether the tax can be imposed consistently with the obligations undertaken thereunder.”⁷⁹³

In *Tradehold* the relevant DTT provided that gains from certain alienations could only be taxed in the residence state.⁷⁹⁴ The court held that the term “alienation” in the relevant treaty “must be given a meaning that is congruent with the language of the DTA having regard to its object and purpose”.⁷⁹⁵ It also held that the parties to the DTT must have been aware of the relevant provisions in the Eighth Schedule to the Income Tax Act and must have intended the treaty to apply to capital gains of the kind provided for in the Eighth Schedule. It therefore held that a deemed disposal in terms of the Eighth Schedule is an “alienation” for purposes of the DTT.

On the basis of this overview of South African case law on the interpretation of treaties, the following general points can be made:

- (a) It seems that in those judgements where the South African courts have referred to the OECD MTC and its Commentary⁷⁹⁶ or other international instruments or reports,⁷⁹⁷ it has followed the international trend (referred to above) of being silent on the basis of the reference. In some cases no mention is made of the OECD model or its

⁷⁹³ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 20.

⁷⁹⁴ Art 13(4) of the OECD MTC.

⁷⁹⁵ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 23.

⁷⁹⁶ See eg *Secretary for Inland Revenue v Downing* 1975 4 SA 518 (A); *ITC 1503* 1990 53 SATC 342 (T); *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

⁷⁹⁷ See eg *Mzeku v Volkswagen SA (Pty) Ltd* 2001 4 SA 1009 (LAC).

Commentary.⁷⁹⁸ South African courts might, therefore, refer to the OECD materials. But whether this will be done, and, if so, on what basis, may not be clear. As argued above, the Constitution does not seem to provide such a basis.

- (b) Both foreign precedent⁷⁹⁹ and the work of academic writers,⁸⁰⁰ are often relied upon as persuasive authority, a practice that is in line with the Constitution.
- (c) The courts will apply the provisions of a DTT and thereby limit or extinguish tax liabilities imposed by the Income Tax Act.⁸⁰¹ Therefore, to the extent that a DTT is applied to legislation existing at the time that a DTT was entered into, the provisions of the treaty will be given precedence. It is submitted that this practice of South African courts are in line with section 233 of the Constitution, although courts rarely expressly refer to this provision on this point.
- (d) The courts generally seem to attribute the natural or ordinary meaning to words used in a treaty. To the extent that the natural or ordinary meaning of words is a reference to an autonomous treaty meaning (and not a meaning as conferred by the domestic law of the relevant states), South African courts appear to be following the international trend of interpreting the provisions of a treaty in accordance with public international law.⁸⁰² This conclusion is supported by the many references in the cases to an interpretation in accordance with the intention of the parties⁸⁰³ (that is, the two contracting states). A case that stands in sharp contrast to the other cases is that of *AM Moolla*. In *AM Moolla* the court attributed the domestic law meaning to the treaty provision and even stated that the treaty meaning would change as domestic legislation changes, both findings based on the fact that the relevant treaty formed part of domestic legislation. No mention was made in the case of section 233 of the Constitution and the court's obligation to interpret the relevant legislation in accordance with international law, provided that it is a reasonable interpretation. Nor was there any reference to any of the cases regarding treaty interpretation. It is submitted that the principles laid down in *Downing* and the other cases cited above, namely that the ordinary meaning should be attributed to the treaty, are preferable, especially in the light of the provisions of the Constitution.

⁷⁹⁸ See eg *Volkswagen of South Africa (Pty) Ltd v Commissioner for the South African Revenue Service* 70 SATC 195; *Grundlingh v Commissioner for the South African Revenue Service* 2009 72 SATC 1; *ITC 1544* 1992 54 SATC 456 (T); *ITC 1735* 2002 64 SATC 455; *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127.

⁷⁹⁹ See eg *Seton Co v Silveroak Industries Ltd* 2000 2 SA 215 (T); *S v H* 2007 3 SA 330 (C); *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127; *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

⁸⁰⁰ See eg *ITC 1735* 2002 64 SATC 455; *ITC 1544* 1992 54 SATC 456 (T).

⁸⁰¹ See eg *Secretary for Inland Revenue v Downing* 1975 4 SA 518 (A); *ITC 1544* 1992 54 SATC 456 (T); *ITC 1503* 1990 53 SATC 342 (T); *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

⁸⁰² Olivier and Honiball suggest that domestic rules of interpretation should be the "initial focus" in interpreting DTTs, but that "international rules" also have to be taken into account (Olivier and Honiball *International Tax: a South African Perspective* 306–307). It is submitted that public international law (that is, the autonomous meaning) is, and should be, applied and not the domestic rules of interpretation.

4.3.3 United Kingdom

In the United Kingdom, courts have acknowledged that a literal approach to the interpretation of DTTs is not appropriate as it may be inconsistent with the purposes of the treaty. If a provision is ambiguous, a purposive construction must be followed. It should be taken into account that the provisions were not drafted by English draftsmen and are not to be interpreted only by English judges. It should be interpreted on broad principles that are generally accepted and not in accordance with technical rules of English law or precedent. One of these broad principles is the rule embodied in article 31(1) of the Vienna Convention requiring good faith in the interpretation of the treaty, in accordance with the ordinary meaning of the terms in their context and in the light of its object and purpose. If this approach is followed, but the meaning of the provision is unclear, ambiguous or leads to an absurd result, supplementary means of interpretation may be consulted. These aids to the interpretation of the treaty, as well as foreign precedents (which may have persuasive value) and academic writings are not a substitute for the study of the terms of the treaty and their use is discretionary, not mandatory.⁸⁰⁴ In *Ben Nevis (Holdings) Ltd v Her Majesty's Revenue and Customs*, the court held that these principles set out above are largely derived from articles 31 and 32 of the Vienna Convention and that there is no conflict between the two. The court furthermore stated that the formulation of these principles in the court cases was in the nature of a summary and that articles 31 and 32 of the Vienna Convention dealt with certain matters which were not included in this formulation.⁸⁰⁵ According to Schwarz “although the Commerzbank principles remain the central statement on tax treaty interpretation in UK law, the Court of Appeal has mandated a more systematic analysis by reference to articles 31 and 32 of the Vienna Convention (1969) in *Ben Nevis*”.⁸⁰⁶

In *Indofood International Finance Ltd v JP Morgan Chase Bank NA*⁸⁰⁷ the court held that the term “beneficial owner” is to be given an international fiscal meaning not derived from the domestic laws of contracting states, confirming that an autonomous meaning should be given to the relevant tax treaty. The OECD Commentary has been used to interpret the meaning of specific articles in United Kingdom DTTs.⁸⁰⁸ Indeed, the Court of Appeal in *Sun Life Assurance Company of Canada v Pearson*⁸⁰⁹ has stated that it is common ground that the court is entitled to consider the Commentary. In *Ben Nevis*, the Court of Appeal referred to certain academic authors, foreign case law, the OECD Commentary and a parallel treaty without commenting on the authority of any of these sources.⁸¹⁰ The court did, however, refuse to admit expert evidence on the interpretation of the relevant DTT and Protocol, stating that its interpretation was a matter for the court.⁸¹¹ Regarding a memorandum of understanding entered into between the two tax authorities, the taxpayer argued that it

⁸⁰⁴ *IRC v Commerzbank AG* [1990] STC 285 297–298; *Memec plc v IRC* 1998 [1998] STC 754 766; *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 para 26.

⁸⁰⁵ *Ben Nevis (Holdings) Ltd v Her Majesty's Revenue and Customs* [2013] EWCA Civ 578 para 17.

⁸⁰⁶ Schwarz (2014) 68 *BFIT* 20 22.

⁸⁰⁷ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] EWCA Civ 158.

⁸⁰⁸ Olivier and Honiball *International Tax: a South African Perspective* 313; Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para E.10.

⁸⁰⁹ *Sun Life Assurance Co of Canada v Pearson* [1986] STC 335 CA.

⁸¹⁰ *Ben Nevis (Holdings) Ltd v Her Majesty's Revenue and Customs* [2013] EWCA Civ 578 paras 33 and 35–38.

See also Schwarz (2014) 68 *BFIT* 20 22–24.

⁸¹¹ *Ben Nevis (Holdings) Ltd v Her Majesty's Revenue and Customs* [2013] EWCA Civ 578 para 34.

could not be used to interpret the DTT and Protocol, since it was not entered into between the states. The court held that:

“Notwithstanding the fact that the Memorandum of Understanding in the present case was concluded between the tax authorities of the Contracting States, I consider that it is admissible on the construction of the 2010 Protocol and the 2002 Convention pursuant to Article 31(2) and/or 31(3), Vienna Convention on the Law of Treaties, as an agreement relating to the treaty, which was made between all the parties in connection with the conclusion of the treaty (Article 31(2)(a)) or a subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions (Article 31(3)(a)) or subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation (Article 31(3)(b)). The Memorandum of Understanding was concluded between the appropriate organs of the Contracting States for this particular purpose. Moreover, I note that in **Commerzbank** Mummery J. was not addressing the status of the joint statement in the context of the Vienna Convention on the Law of Treaties.”⁸¹²

4.3.4 Canada

In Canada the courts have accepted that rules governing the interpretation of treaties are different to those governing the interpretation of domestic law. A more liberal approach is, therefore, applied in the interpretation of DTTs, in “the interests of the comity of nations”.⁸¹³ In *Crown Forest Industries* the Supreme Court of Canada has stated that the paramount goal in interpreting a treaty is to find the meaning of the relevant words and that this process involves considering the language used and the intention of the parties.⁸¹⁴ The courts have also accepted that the rules of the Vienna Convention are applicable to Canadian DTTs.⁸¹⁵ The Supreme Court has indicated that the OECD MTC and Commentary form part of the legal context of the treaty and, therefore, play an important role in the interpretive process.⁸¹⁶ These may then be referred to without the need to first find an ambiguity.⁸¹⁷ In *Her Majesty the Queen v Prévost Car Inc* the Federal Court of Appeal also stated that the Commentary was “a widely-accepted guide to the interpretation and application of the provisions of existing bilateral conventions”.⁸¹⁸

4.3.5 The Netherlands

In the Netherlands the courts have indicated that the OECD Commentary is of great importance in the interpretation of DTTs.⁸¹⁹ Case law suggests that courts willingly look to

⁸¹² *Ben Nevis (Holdings) Ltd v Her Majesty's Revenue and Customs* [2013] EWCA Civ 578 para 39.

⁸¹³ *MNR v Saunders* (1954) 54 DTC 524 526. See also *Crown Forest Industries Ltd v The Queen* [1995] 2 SCR 802; Kandeve (2007) 55 *Canadian Tax Journal* 31 35; Olivier and Honiball *International Tax: a South African Perspective* 311; Watson and Baum (2012) 60 *Canadian Tax Journal* 149 153.

⁸¹⁴ *Crown Forest Industries Ltd v The Queen* [1995] 2 SCR 802 para 22.

⁸¹⁵ Hausman (2001) 55 *BFIT* 93 93; Kandeve (2007) 55 *Canadian Tax Journal* 31 36.

⁸¹⁶ Ward (2006) 60 *BFIT* 97 99; *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57 para 10.

⁸¹⁷ *Crown Forest Industries Ltd v The Queen* [1995] 2 SCR 802; *RMM Canadian Enterprises Inc v R* (1997) 97 DTC 302 315.

⁸¹⁸ *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57 para 10.

⁸¹⁹ Van Brunschot (2005) 59 *BFIT* 5 6; Erasmus-Koen and Douma (2007) 61 *BFIT* 339 349.

the commentary for help in the interpretation of treaties.⁸²⁰ The Dutch Ministry of Finance has also acknowledged the importance of the OECD MTC and its Commentary in the interpretation of treaties.⁸²¹

4.4 Status of tax treaties

There are different procedures by which DTTs form part of domestic law in each state.⁸²² In some states the treaty automatically becomes part of domestic law when it takes effect. In other states the treaty becomes part of domestic law upon parliamentary approval, whilst in still others legislation is needed to make the treaty part of domestic law.⁸²³ In some countries, once the treaty becomes part of the domestic law, it has no higher status than any other law. If there is a conflict between the provisions of a tax treaty and the domestic income tax legislation, the question that arises is how the conflict should be resolved. In countries where a treaty has a higher status than domestic legislation, a conflict is resolved by the treaty's higher status.⁸²⁴

4.4.1 South Africa

The Constitution provides that an international agreement binds the Republic only after it has been approved by resolution in both the National Assembly and the National Council of Provinces.⁸²⁵ Furthermore, any international agreement becomes law in the Republic when it is enacted into law by national legislation.⁸²⁶ In other words, in order to be bound on an

⁸²⁰ Van Brunschot (2005) 59 *BFIT* 5 10.

⁸²¹ Ministerie van Financiën *Notitie Fiscaal Verdragsbeleid* para 1.3.3.

⁸²² Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para F.01.

⁸²³ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para F.01.

⁸²⁴ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para F.03; Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 48.

⁸²⁵ Constitution of the Republic of South Africa s 231(2). S 231(3) provides that an agreement of a technical, administrative or executive nature, or an agreement which does not require either ratification or accession, entered into by the national executive binds the Republic, without the need for parliamentary approval. It is submitted that the provisions of s 108(2), which envisages parliamentary approval, indicate that DTTs are not of the kind referred to in s 231(3). In practice, DTTs are dealt with in terms of s 231(2) (Olivier and Honiball *International Tax: a South African Perspective* 295).

⁸²⁶ Constitution of the Republic of South Africa s 231(4), which provides that "[a]ny international agreement becomes law in the Republic when it is enacted into law by national legislation, but a self-executing provision of an agreement that has been approved by Parliament is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament". The concept of a self-executing provision is controversial. Scholtz is of the view that the incorporation of the concept of the self-executing provision in the Constitution is unfortunate and argues convincingly that the reference to self-executing provisions can be ignored (Scholtz (2004) 29 *SAYIL* 202 216). Dugard asserts that a treaty will be self-executing "only if the language of the treaty so indicates and existing municipal law, either common law, or statute, is adequate in the sense that it fails to place any obstacle in the way of treaty application" (Dugard *International Law: a South African Perspective* 57). Ferreira and Scholtz approve of Dugard's definition and add "that the only way in which a South African court can decide whether a treaty is a self-executing treaty in terms of section 231(4), is to establish first and foremost the extent to which the domestic law allows for the application of the provisions of the treaty and only thereafter decide whether the particular treaty should be declared to be self-executing or not" (Ferreira and Scholtz (2009) XL *CILSA* 264 269). See also Swanepoel (2013) 10 *LitNet Akademies*. Some academic authors are of the view that DTTs are not self-executing, (eg Brincker in *Silke on International Tax* para 12.7.1; Olivier and Honiball *International Tax: a South African Perspective* 304) whilst others argue that treaties are self-executing

international law level, South Africa requires parliamentary approval for a DTT. Thereafter, and in order for it to form part of South African domestic law, enactment by national legislation is required.⁸²⁷

There are three methods available to the legislator by which a treaty may be incorporated into domestic law. One of these is an enabling act of Parliament which gives the executive the power to domesticate the treaty by means of proclamation or notice in the *Government Gazette*.⁸²⁸ The Income Tax Act provides that the national executive may enter into DTTs with other countries.⁸²⁹ It further provides that once Parliament has approved the relevant treaty, the treaty must be published in the *Gazette*, whereupon the treaty shall have effect as if enacted in the Income Tax Act.⁸³⁰ The Income Tax Act therefore constitutes the national legislation, required by the Constitution, by which the DTT becomes part of domestic law.

Once a treaty has been domesticated via legislation, ordinary domestic statutory obligations are created.⁸³¹ The minority judgement in *Glenister* stated the position more emphatically and suggested what would happen when a conflict arises:

“It is implicit, if not explicit, from the scheme of s 231 that an international agreement that becomes law in our country enjoys the same status as any other legislation. This is so because it is enacted into law by national legislation, and can only be elevated to a status superior to that of other national legislation if Parliament expressly indicates its intent that the enacting legislation should have such status. On certain occasions, Parliament has done this by providing that, in the event of a conflict between the international convention that has been incorporated and ordinary domestic law, the international agreement would prevail. The amicus therefore properly accepted that, upon incorporation under s 231(4), an international agreement assumes the status of ordinary legislation in our law. In addition, the amicus also accepted, quite properly, that, if there is a conflict between an international agreement that has been incorporated into our law and another piece of legislation, that conflict must be

(Hattingh (2009) 63 *BFIT* 442 446; Hattingh in *Silke on International Tax* para 36.14). The view preferred in this dissertation is that a DTT is not self-executing.

⁸²⁷ Hattingh in *Silke on International Tax* para 36.14 is of the view that enactment by national legislation is not required. According to Hattingh, South Africa’s DTTs must be approved by Parliament in terms of s 231(2) of the Constitution, a DTT not being an agreement of a technical, administrative or executive nature or an agreement which does not require either ratification or accession (as envisaged in s 231(3) of the Constitution). He argues, however, that South Africa’s DTTs are self-executing and therefore do not require national legislation in order to become law in South Africa. In terms of his argument, the purpose of s 108 is to empower the tax administration to carry out treaty obligations in the context of the powers granted under the Income Tax Act. S 108 therefore does not serve to grant rights to taxpayers in terms of the treaty. Hattingh states that s 108 of the Income Tax Act is not proper enacting legislation. His argument is based on the fact that South Africa does not pass separate legislation for each and every DTT entered into by South Africa, as is done in the United Kingdom.

⁸²⁸ Dugard *International Law: a South African Perspective* 61, cited with approval in the minority judgement by Ngcobo CJ in *Glenister v President of the Republic of South Africa* 2011 3 SA 347 (CC) para 55. The other two methods mentioned by Dugard are that the provisions of the treaty may be set out in the wording of an act of parliament and the treaty may be incorporated as a schedule to the legislation. See also *Commissioner for the South African Revenue Service v Van Kets* 2012 3 SA 399 (WCC) para 18.

⁸²⁹ Income Tax Act 58 of 1962 s 108(1).

⁸³⁰ Income Tax Act 58 of 1962 s 108(2).

⁸³¹ Per Moseneke DCJ and Cameron J delivering the majority judgement in *Glenister v President of the Republic of South Africa* 2011 3 SA 347 (CC) para 181.

resolved by the application of the principles relating to statutory interpretation and superseding of legislation.”⁸³²

In a footnote, the minority suggested that subsequent legislation, which conflicts with the legislation domesticating the international agreement, would supersede the domesticating legislation (in the absence of a provision in the domesticating legislation that it would prevail over subsequent legislation). However, since the matter was not before the court, it explicitly chose not to express a firm view on the matter.⁸³³

The conclusion that may be drawn from the above is that, according to both judgements in *Glenister*,⁸³⁴ a treaty, once it is domesticated via legislation, has the same status as other legislation. In the case of DTTs, this would imply that a DTT, which is domesticated via section 108 of the Income Tax Act, enjoys no higher status than any other provision of the Income Tax Act.⁸³⁵

In the *AM Moolla* case⁸³⁶ the court, whose judgement was centred wholly on the fact that the treaty formed part of the Customs and Excise Act, held that if there were to be an apparent conflict between general provisions of the Customs and Excise Act and particular provisions of the treaty, the Act must prevail. However, the treaty must be construed in such a way as to avoid any conflict between the Act and the terms of the treaty and on the facts the court found that the Act gave content to the expressions used in the treaty, with the result that no conflict arises between the Act and the treaty.

The judgement in *Moolla* appears to be in conflict with the minority judgement in *Glenister* insofar as the *Moolla* case suggests that the provisions of the Customs and Excise Act will prevail over a treaty which forms part of the Act, whilst the minority judgement in *Glenister* clearly indicates that the normal principles of statutory interpretation must be followed to resolve the conflict.

The status of DTTs was recently pronounced on in the case of *Commissioner for the South African Revenue Service v Van Kets*.⁸³⁷ In this case the Australian Tax Office (ATO) requested SARS to provide certain information in terms of the DTT between South Africa and Australia. The information required by the ATO related to an Australian resident, a certain Saville, and his links with a non-resident company known as RLCF. The relevant information was held by Van Kets and SARS attempted to use sections 74A and 74B of the Income Tax Act⁸³⁸ to obtain information regarding Saville and RLCF from Van Kets. These sections enable SARS, “for the

⁸³² *Glenister v President of the Republic of South Africa* 2011 3 SA 347 (CC) paras 100–101.

⁸³³ *Glenister v President of the Republic of South Africa* 2011 3 SA 347 (CC) footnote 88.

⁸³⁴ For criticism against both the majority and minority judgements in *Glenister*, see Tuovinen (2013) 130 *SALJ* 661.

⁸³⁵ Brincker in *Silke on International Tax* para 12.2; Olivier and Honiball *International Tax: a South African Perspective* 303; *Commissioner for the South African Revenue Service v Van Kets* 2012 3 SA 399 (WCC) para 25. For a contrary view, see Hattingh in *Silke on International Tax* para 36.14, who argues that “the Constitution places South Africa’s commitments under international tax treaties, once approved by Parliament, at a level superior to ordinary parliamentary legislation (such as the Income Tax Act)”.

⁸³⁶ *AM Moolla Group Ltd v Commissioner for the South African Revenue Service* 2003 65 SATC 414.

⁸³⁷ *Commissioner for the South African Revenue Service v Van Kets* 2012 3 SA 399 (WCC). For further comment on the case see Anonymous (2011) 60 *The Taxpayer* 232.

⁸³⁸ Income Tax Act 58 of 1962.

purposes of the administration of the Act in relation to any taxpayer”, to procure information from such taxpayer or any other person. Van Kets argued that since neither Saville nor RLCF were “taxpayers”, as defined, SARS could not rely on the relevant sections in the Income Tax Act to obtain the information from him. A “taxpayer” is defined, *inter alia*, as any person chargeable with any tax under the Income Tax Act.⁸³⁹ Since Van Kets was not chargeable with tax, but merely held information, he could not be regarded as a taxpayer. SARS argued that these sections of the Income Tax Act were the means by which it invoked the power to obtain information requested by foreign revenue authorities in terms of DTTs. If Van Kets’s argument were to succeed, SARS argued that it would not have any legislative mechanism to obtain the information, available in South Africa, which it was obliged to provide to the foreign tax authorities, unless the information related to a “taxpayer”.

Article 25 of the South Africa-Australia DTT provides, *inter alia*, as follows:

“(1) The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Agreement or to the administration or enforcement of the domestic law concerning taxes referred to in Article 2, insofar as the taxation thereunder is not contrary to the Agreement. The exchange of information is not restricted by Article 1.”

And further:

“(3) In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

- (a) to carry out administrative measures at variance with the law and administrative practice of that or of the other Contracting State;
- (b) to supply information which is not obtainable by the competent authority under the law or in the normal course of the administration of that or of the other Contracting State[.]”

The court cited section 108 of the Income Tax Act and referred to the dates and *Gazettes* by which the relevant treaty came into force and was amended, respectively. The court further referred to sections 231(2) to (4) of the Constitution and the majority judgement in *Glenister*, concluding that “[t]he effect of s 108 is thus to ensure that domestic statutory obligations are created”. Moreover, the court found, based on these sections in the Constitution and the guidance of the Constitutional Court in *Glenister*, that the Income Tax Act was an enabling act, giving the executive the power to bring a treaty into effect in South African law by means of a notice in the *Government Gazette*.⁸⁴⁰ After reference was made to a textbook,⁸⁴¹ the court found that the provisions of a DTT rank at least equally with domestic law, including the Income Tax Act and that the provisions of these two documents should, therefore, be “reconciled and read as one coherent whole”.⁸⁴² The court held that the relevant DTT had to be interpreted as part of the Income Tax Act and that consequently

⁸³⁹ Income Tax Act 58 of 1962 s 1.

⁸⁴⁰ *Commissioner for the South African Revenue Service v Van Kets* 2012 3 SA 399 (WCC) para 18.

⁸⁴¹ Olivier and Honiball *International Tax: a South African Perspective* 305.

⁸⁴² *Commissioner for the South African Revenue Service v Van Kets* 2012 3 SA 399 (WCC) para 22.

sections 74A and 74B had to be interpreted so as to be compatible with the provisions of the DTT. The word “taxpayer” should, therefore, include those taxpayers who fall within the scope of the DTT. Since an Australian resident, such as Saville, would fall within the scope of the DTT, he would also be regarded as a taxpayer, making section 74 applicable to Van Kets as “any other person” who would be obliged to furnish information regarding a taxpayer, namely Saville.

It was argued before the court that article 25 of the DTT expressly provides that South Africa is not obliged to carry out administrative measures at variance with South African law or supply information which is not obtainable under South African law. In terms of this argument, SARS’s powers are limited by sections 74A and 74B, read with the definition of “taxpayer”, to information relating to a taxpayer, as defined. Hence SARS could not provide the information requested by the ATO in terms of the DTT, as SARS was unable to use sections 74A and 74B to procure the information. It seems that the court did not directly address this point, save to state that such an argument would cause an inconsistency to the extent that SARS would not be able to comply with the ATO’s request. It then relies on the fact that the DTT forms part of the Income Tax Act and that the “compatible” interpretation, set out above, should be followed.

The court therefore did not so much interpret the DTT, but rather chose to expand the meaning of the term “taxpayer” in the Income Tax Act, *because of* an article in the DTT. In effect, the court changed the meaning ascribed to a term in terms of the definition section. There is a long line of cases in South African law which deals with the departure from a defined term when interpreting legislation. Pertinent in tax matters is the case of *Commissioner for Inland Revenue v Simpson*,⁸⁴³ in which Watermeyer, CJ, stated that:

“it seems to me that effect should be given to the rule laid down by Halsbury, *Laws of England*, in para. 591 of Vol. 31 (Hailsham ed.), viz.:

‘A definition section does not necessarily apply in all the possible contexts in which a word may be found in the statute. If a defined expression is used in a context which the definition will not fit, it may be interpreted according to its ordinary meaning.’”

In dealing with the same topic, the Supreme Court of Appeal in *Hoban v Absa Bank Ltd t/a United Bank*⁸⁴⁴ quoted, with approval, a passage from *Canca v Mount Frere Municipality*⁸⁴⁵ in which it was stated that:

“The principle which emerges is that the statutory definition should prevail unless it appears that the Legislature intended otherwise and, in deciding whether the Legislature so intended, the Court has generally asked itself whether the application of the statutory definition would result in such injustice or incongruity or absurdity as to

⁸⁴³ *Commissioner for Inland Revenue v Simpson* 1949 4 SA 678 (A) 692.

⁸⁴⁴ *Hoban v ABSA Bank Ltd t/a United Bank* 1999 2 SA 1036 (SCA) 1044.

⁸⁴⁵ *Canca v Mount Frere Municipality* 1984 2 SA 830 (Tk).

lead to the conclusion that the Legislature could never have intended the statutory definition to apply.”⁸⁴⁶

The Supreme Court of Appeal in the same case further explained that “context” should not be limited to parts of a legislative provision which immediately precede and follow the specific passage under examination, but includes the entire enactment in which the word appear, and in its widest sense also enactments *in pari materia* and the situation or “mischief” sought to be remedied. Furthermore, the court held that the legislative intention must be ascertained when analysing the context.⁸⁴⁷ The test accepted in the *Hoban* case has been approved in other judgements of the Supreme Court of Appeal,⁸⁴⁸ as well as by the Constitutional Court.⁸⁴⁹

It seems that the court in the *Van Kets* case did not apply the test laid down in the above-mentioned cases when it decided to expand the meaning of the word “taxpayer” to include those who fall within the scope of the DTT. It is submitted that the court’s finding that the DTT forms part of the Income Tax Act and ranks equally to all the other provisions of the Income Tax Act, is correct in the light of the *Glenister* case and the provisions of the Constitution. Bearing in mind the point made about the meaning of context in the *Hoban* case, it is fair to assume that the relevant DTT forms part of the context when interpreting the definition of “taxpayer”.⁸⁵⁰ The purpose of the relevant sections of the Income Tax Act and the articles of the DTT would also have to be ascertained to paint the full picture of the context. One would then have to ask whether the application of the definition of “taxpayer” would result in an injustice or incongruity or absurdity, given this context.

Applying this analysis, the purpose of the relevant provisions will now be examined. The purpose of inserting a provision such as article 25 into a DTT is set out as follows by the OECD:

“In the first place it appears to be desirable to give administrative assistance for the purpose of ascertaining facts in relation to which the rules of the Convention are to be applied. Moreover, in view of the increasing internationalisation of economic relations, the Contracting States have a growing interest in the reciprocal supply of information on the basis of which domestic taxation laws have to be administered, even if there is no question of the application of any particular article of the Convention.”⁸⁵¹

⁸⁴⁶ *Canca v Mount Frere Municipality* 1984 2 SA 830 (Tk) 832.

⁸⁴⁷ *Hoban v ABSA Bank Ltd t/a United Bank* 1999 2 SA 1036 (SCA) 1044.

⁸⁴⁸ *ABP 4x4 Motor Dealers (Pty) Ltd v IGI Insurance Co Ltd* 1999 3 SA 924 (SCA); *Ndlovu v Ngcobo*; *Bekker v Jika* 2003 1 SA 113 (SCA).

⁸⁴⁹ *Walele v City of Cape Town* 2008 6 SA 129 (CC).

⁸⁵⁰ The Tax Administration Act 28 of 2011, s 151 tries to address the shortcoming in the definition of “taxpayer” highlighted in the *van Kets* case by defining a “taxpayer” to mean, *inter alia*, “a person who is the subject of a request to provide assistance under an international tax agreement.” That Act continues to provide in s 46(1) that SARS may, for the purposes of the administration of a tax Act in relation to a taxpayer, whether identified by name or otherwise objectively identifiable, require the taxpayer or another person to, within a reasonable period, submit relevant material (whether orally or in writing) that SARS requires. The administration of a tax means, *inter alia*, to give effect to the obligation of the Republic to provide assistance under an international tax agreement. (Tax Administration Act 28 of 2011 s 3(2)(i)).

⁸⁵¹ Commentary on the OECD MTC art 26 para 1.

The court in *Van Kets* did refer to the purpose of article 25 by way of an example, but no reference was made to the OECD MTC or its commentary.

Croome and Olivier describe the purposes of sections 74A and 74B as ensuring that each taxpayer pays the correct amount of tax,⁸⁵² that SARS may verify information contained in a tax return⁸⁵³ and to broaden the tax base.⁸⁵⁴

The context within which the meaning of the definition of “taxpayer” is to be evaluated is, therefore, the whole of the Income Tax Act, which includes the relevant, equally ranking, DTT and the purpose of the relevant provisions as set out above. Articles 25(3)(a) and (b) of the DTT, which provide that South Africa is not obliged to act contrary to the Income Tax Act, limit South Africa’s obligations in terms of the DTT. This limitation forms part of the context and should inform the interpretation of the definition of “taxpayer”. It is, therefore, submitted that applying the defined meaning to the term “taxpayer” would not result in an injustice or incongruity or absurdity. Consequently, it is submitted that the court was not justified in extending the meaning of the term “taxpayer” as it did in the case.

It is furthermore submitted that the court should have considered the provisions of section 233 of the Constitution. That section obliges the court to prefer any reasonable interpretation of the word “taxpayer” and sections 74A and 74B, that is consistent with the relevant DTT,⁸⁵⁵ over any alternative interpretation that is inconsistent with such treaty. Articles 25(3)(a) and (b) themselves state that South Africa’s obligations under the treaty are limited to what is allowed under the Income Tax Act, namely articles 74A and 74B read with the definition of “taxpayer”. South Africa’s obligations in terms of article 25(1) of the DTT are, therefore, limited to that which is allowable in terms of the Income Tax Act. Interpreting the term “taxpayer” in accordance with its defined meaning would have been consistent with the relevant treaty, as is required by section 233 of the Constitution.

In the recent case of *Commissioner for the South African Revenue Service v Tradehold Ltd*⁸⁵⁶ the court again had the opportunity to pronounce on the status of DTTs in South Africa. The court referred to section 108 of the Income Tax Act, calling it “enabling legislation” and then held that “[o]nce brought into operation a double tax agreement has the effect of law”.⁸⁵⁷ The court described the “legal effect” of a DTT by quoting a passage from *Downing*, which also stated that a treaty has effect as if enacted in the Income Tax Act.⁸⁵⁸

By referring to section 108 as “enabling legislation” the court, arguably, confirmed the argument set forth above, namely that the Income Tax Act, more specifically section 108, serves as the national legislation which is required to domesticate the international agreement entered into by the national executive.⁸⁵⁹ The court, however, did not address this point directly, which is a pity, given the divergence of views regarding the process required for domestication of DTTs.

⁸⁵² Croome and Olivier *Tax Administration* 110.

⁸⁵³ Croome and Olivier *Tax Administration* 111.

⁸⁵⁴ Croome and Olivier *Tax Administration* 118.

⁸⁵⁵ The DTT being a source of international law.

⁸⁵⁶ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

⁸⁵⁷ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 16.

⁸⁵⁸ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 16.

⁸⁵⁹ As is required by the Constitution of the Republic of South Africa s 231(4).

Regarding the court's statement that "a double tax agreement has the effect of law", it is noticeable that the court did not specifically state whether the DTT ranks higher, equally or lower than other domestic legislation.⁸⁶⁰ The court did refer to a passage in *Downing* in which it was stated that the treaty has effect as if enacted in the Income Tax Act, giving the impression that the court views the treaty as part of the Income Tax Act. It is interesting to note that the court did not refer to the *Glenister* case, in which the majority of the court specifically held that ordinary domestic statutory obligations are created when a treaty is domesticated. However, the court continued to state the following:

"Double tax agreements effectively allocate taxing rights between the contracting states where broadly similar taxes are involved in both countries. They achieve the objective of s 108, generally, by stating in which contracting state taxes of a particular kind may be levied or that such taxes shall be taxable only in a particular contracting state or, in some cases, by stating that a particular contracting state may not impose the tax in specified circumstances. A double tax agreement thus modifies the domestic law and will apply in preference to the domestic law to the extent that there is any conflict."⁸⁶¹

It may be argued that the court, when it stated that a DTT applies in preference to domestic law, referred to domestic law existing at the time when the treaty came into effect. However, in the very next paragraph, the court acknowledges that "double tax agreements are intended to encompass not only existing taxes, but also taxes which may come into existence at later dates (see Art 2(2))".⁸⁶² The court was, therefore, very much aware of the influence of subsequent legislation on existing treaties. It is submitted that the court effectively stated that a DTT will always apply in preference to domestic law in the case of conflict. The court did not refer to the *Glenister*, *Van Kets* or *AM Moolla* decisions in making this point.

In examining the South African case law⁸⁶³ regarding the conflict between the relevant act and DTTs in South Africa, it is submitted that three views may be distinguished:

- (a) The view expounded in *AM Moolla*, namely that the treaty forms part of the relevant act and in the case of conflict between the general provisions of the relevant act and particular provisions of the treaty, the act must prevail. However, the treaty must be construed in such a way as to avoid any conflict between the act and the terms of the treaty. In *AM Moolla* the court found, on the facts, that the Act gave content to the

⁸⁶⁰ In support of the view that a DTT and the Income Tax Act rank equally, it could possibly be argued that the court did not state the obvious, but that it meant to say that DTTs do not rank higher or lower than the Income Tax Act.

⁸⁶¹ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 17.

⁸⁶² *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 18.

⁸⁶³ Academic writers hold different views regarding the possibility of so-called "treaty override". Hattingh is of the view that any attempt to override South Africa's obligations in terms of a DTT by means of subsequent legislation will be unconstitutional (Hattingh in *Silke on International Tax* para 36.14). Brincker suggests that since a DTT is not incorporated into domestic legislation by means of specific adoption, the treaty may override the national legislation except to the extent that the national legislation specifically provides otherwise (Brincker in *Silke on International Tax* 12.7.1). Olivier and Honiball also indicate that domestic legislation may, in some circumstances, override a DTT (Olivier and Honiball *International Tax: a South African Perspective* 317).

expressions used in the treaty, with the result that no conflict arose between the Act and the treaty.

- (b) The Supreme Court of Appeal in *Tradehold* was of the view that a DTT modifies the domestic law and will apply in preference to the domestic law to the extent that there is any conflict.
- (c) In *Glenister* both judgements indicated that ordinary domestic statutory obligations are created once a treaty is domesticated via legislation. The minority was of the view that if there is a conflict between a domesticated international agreement and other domestic legislation, the conflict must be resolved by the application of the principles of statutory interpretation and superseding of legislation. The judgement in *Van Kets* seems to follow the minority's view to the extent that the court in *Van Kets* found the provisions of a DTT to rank at least equally with domestic law and that the provisions of the Income Tax Act and the DTT should, therefore, be "reconciled and read as one coherent whole".

It is submitted that the preferred view is that of the minority in *Glenister*. Thus it is suggested that a DTT and the Income Tax Act, which domesticates the treaty, ranks equally and that in the case of conflict between the provisions of a DTT and the Income Tax Act, the normal principles of statutory interpretation should be followed to resolve the conflict.⁸⁶⁴ It is submitted that these principles would include:

- (a) A reference to section 233 of the Constitution which compels a court to prefer any reasonable interpretation of the Income Tax Act that is consistent with international law over any alternative interpretation that is inconsistent with international law. In other words, the Income Tax Act should be interpreted in a way that is consistent with South Africa's DTTs, being a source of international law,⁸⁶⁵ unless such an interpretation is unreasonable. Therefore, a court will be compelled to interpret the Income Tax Act in such a way that taxation is limited in accordance with the provisions of a treaty, unless such an interpretation is unreasonable. It is argued above that South African courts have thus far not hesitated in letting the provisions of a DTT prevail over the provisions of the Income Tax Act (*AM Moolla* being an exception) and it is submitted that such an approach is in line with the Constitution.

In interpreting subsequent legislation which conflicts with an existing treaty, a court would have to pay particular attention to the requirement of reasonableness.

- (b) The maxim *lex posterior priori derogate*,⁸⁶⁶ a rule specifically referred to by the minority in *Glenister* in the relevant footnote, albeit completely *obiter*. This rule has been described as follows:

"A statutory provision clearly inconsistent and irreconcilable with its preceding, hierarchically equal or subordinate counterparts *in pari materia* revokes them to the extent of such inconsistency and irreconcilability."⁸⁶⁷

⁸⁶⁴ Olivier and Honiball *International Tax: a South African Perspective* 315 seem to support this view.

⁸⁶⁵ Dugard *International Law: a South African Perspective* 25.

⁸⁶⁶ Olivier and Honiball *International Tax: a South African Perspective* 317.

The rule is, however, qualified in a number of respects, one of which is that subsequent legislation dealing in general terms with a matter will not prevail over more specific prior legislation (*generalia specialibus non derogant*).⁸⁶⁸

If this rule were to be applied, it would be possible for subsequent provisions of the Income Tax Act to override provisions of a treaty. However, a treaty entered into after enactment of a relevant provision in the Income Tax Act would not be caught by such a rule.

(c) The presumption that legislation does not violate international law.⁸⁶⁹

4.4.2 United Kingdom

In the United Kingdom the power to make treaties rests with the Crown and authority to negotiate and conclude treaties is given to her agents.⁸⁷⁰ DTTs are binding on the United Kingdom in international law as soon as they are concluded, but they do not have effect as part of domestic law unless legislative action is taken. Therefore, the Taxation (International and Other Provisions) Act⁸⁷¹ provides the enabling legislation for treaties to take effect in domestic law by providing that DTTs shall have effect if Her Majesty by Order in Council declares the arrangements made.⁸⁷² Authority indicates that taxpayers' rights accrue by virtue of the legislation incorporating the treaty and not by virtue of the treaty itself.⁸⁷³

In the United Kingdom a subsequent treaty prevails over existing legislation.⁸⁷⁴ Two cases in the United Kingdom seem to suggest that subsequent legislation overrides an earlier treaty.⁸⁷⁵ However, the legislation relevant in these cases did not contain a provision similar to that in the current Taxation (International and Other Provisions) Act, namely that "double taxation arrangements have effect in accordance with subsections (2) to (4) despite anything in any enactment".⁸⁷⁶ Thus the relevant legislation provides that a treaty shall override legislation. One qualification must be added to this statement, namely that if Parliament specifically intended legislation to override a treaty, the legislation will prevail, and not the treaty.⁸⁷⁷

⁸⁶⁷ Du Plessis in LAWSA para 293.

⁸⁶⁸ Du Plessis in LAWSA para 293.

⁸⁶⁹ See the discussion of this presumption in Du Plessis in LAWSA para 388.

⁸⁷⁰ Schwarz *Schwarz on Tax Treaties* para 10–100.

⁸⁷¹ Taxation (International and Other Provisions) Act 2010. This Act repealed the Income and Corporation Taxes Act 1988 s 788, which previously governed DTTs.

⁸⁷² Schwarz *Schwarz on Tax Treaties* para 10–200. Schwarz in *Cahiers de Droit Fiscal International: Practical Issues in the Application of Double Tax Conventions* 703; Panayi *Double Taxation, Tax treaties, Treaty-shopping and the European Community* 19; Harris and Oliver *International Commercial Tax* 21. See also *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 para 9.

⁸⁷³ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para F.02; Panayi *Double Taxation, Tax treaties, Treaty-shopping and the European Community* 19.

⁸⁷⁴ Schwarz *Schwarz on Tax Treaties* para 10–600.

⁸⁷⁵ *IRC v Collco Dealings Ltd* (1961) 39 TC 509 (HL); *Woodend (KV & Ceylon) Rubber & Tea Co Ltd v CIR* [1971] AC 321.

⁸⁷⁶ Taxation (International and Other Provisions) Act 2010 s 6(1). Previously a similar provision was contained in Income and Corporation Taxes Act 1988 s 788(3).

⁸⁷⁷ *Padmore v IRC (No 2)* [2001] STC 280; See Schwarz *Schwarz on Tax Treaties* para 10–600 for examples where legislation specifically overrode a DTT.

4.4.3 Canada and the Netherlands

In Canada, each treaty forms part of domestic law via separate legislation.⁸⁷⁸ In this legislation it is provided that the treaty will prevail over domestic legislation.⁸⁷⁹

In the Netherlands, a treaty becomes domestic law when it is published.⁸⁸⁰ Furthermore, treaties are given a special status.⁸⁸¹ Thus, treaties will prevail over domestic law, even if the domestic legislation entered into force after the treaty did.⁸⁸²

4.5 Conclusion

South Africa is not a party to the Vienna Convention, but it is submitted that the important principles regarding interpretation of treaties contained in articles 31 and 32 of the Vienna Convention is customary international law and, therefore, forms part of South African law via section 232 of the Constitution.

The OECD MTC and its Commentary is not international law and therefore it does not form part of South African law in terms of the Constitution. Furthermore, the Constitution does not oblige a court to interpret the Income Tax Act in a way that is consistent with the OECD MTC or its Commentary. The case law reveals that some South African courts seem to ignore the OECD MTC and its Commentary. Other South African courts acknowledge the importance of the OECD MTC and Commentary and rely on these in their decisions, but the basis on which this is done, is not expressed. It is submitted that the Supreme Court of Appeal's latest recognition of the importance of the OECD MTC in the *Tradehold* case will induce other courts to refer to OECD material, albeit without guidance from this court regarding the grounds for such reference.

⁸⁷⁸ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para F.01, Vogel et al *Klaus Vogel on Double Taxation Conventions* 25; Ward et al *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries of the OECD Model* 55. Bowman and Baker are of the view that DTTs are binding on Canada without implementing legislation, but that it is practice to introduce legislation in Parliament to adopt the provisions of each DTT, to ensure consistency between the Income Tax Act and the relevant treaty (Bowman and Baker in *Cahiers de Droit Fiscal International: Practical Issues in the Application of Double Tax Conventions* 286).

⁸⁷⁹ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para F.04. However, Olivier and Honiball contend that "treaty law will not override Canadian domestic law" (Olivier and Honiball *International Tax: a South African Perspective* 304).

⁸⁸⁰ *Grondwet voor het Koninkrijk der Nederlanden* 2002 s 93 reads as follows: "Bepalingen van verdragen en van besluiten van volkenrechtelijke organisaties, die naar haar inhoud een ieder kunnen verbinden, hebben verbindende kracht nadat zij zijn bekendgemaakt." See also Ward et al *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries of the OECD Model* 60; Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 49.

⁸⁸¹ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para F.03; Erasmus-Koen and Douma (2007) 61 *BFIT* 339 349.

⁸⁸² *Grondwet voor het Koninkrijk der Nederlanden* 2002 s 94 reads as follows: "Binnen het Koninkrijk geldende wettelijke voorschriften vinden geen toepassing, indien deze toepassing niet verenigbaar is met een ieder verbindende bepalingen van verdragen en van besluiten van volkenrechtelijke organisaties." See also Ministerie van Financiën *Notitie Fiscaal Verdragsbeleid* para 2.19; Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* 49; Anonymous in *Nederlandse Regelingen van International Belastingrecht* I.A.-49; Harris and Oliver *International Commercial Tax* 20.

With one exception, South African courts seem to interpret DTTs in accordance with public international law, thereby following the trend internationally. Thus, treaties are generally interpreted by South African courts in accordance with the ordinary meaning of words and the intentions of the state parties to the treaty.

South African courts apply DTTs to limit existing legislation, thereby giving precedence to treaties in relation to legislation existing at the time that the treaty was entered into. It is submitted that this is in accordance with the Constitution.

It is further submitted that South Africa is bound to its DTTs on an international level, once a DTT is approved by Parliament. The DTT becomes part of domestic law, once it is published in the *Government Gazette*. Although the DTT forms part of the Income Tax Act, it is not yet settled whether the DTT outranks the other provisions of the Income Tax Act in a case of conflict. Three views were identified by studying case law, namely that (a) the Income Tax Act must prevail (*AM Moolla*), (b) a treaty modifies domestic law and will apply in preference to domestic law in the case of conflict (*Tradehold*) and (c) the legislation and treaty rank equally and any conflict must be resolved by the application of the principles of statutory interpretation and superseding legislation (minority in *Glenister* and *Van Kets*). Although the view preferred in this dissertation is the last one (that is, (c)), it is acknowledged that view (b) will probably be applied in future in South Africa, as the judgement was one by the Supreme Court of Appeal and dealt specifically with DTTs.

The United Kingdom is a party to the Vienna Convention. The courts in the United Kingdom have laid down their approach to the interpretation of treaties, which includes that the purpose of the treaty must be given effect to, rather than following a literal approach. The courts have also applied the principles embodied in the Vienna Convention and have accepted the use of the international fiscal meaning of words. The courts in the United Kingdom use the OECD Commentary in the interpretation of their tax treaties.

In the United Kingdom, DTTs become part of domestic law once an Order in Council declares that the treaty has been made. Legislation provides that a treaty will override domestic legislation. If Parliament specifically intended legislation to override a treaty, the legislation will, however, prevail and not the treaty.

Canada is a party to the Vienna Convention and their courts have accepted that the rules of the Vienna Convention apply to Canadian DTTs. The courts have also accepted that rules governing the interpretation of treaties are different to those governing the interpretation of domestic law. In interpreting DTTs, the most important objective is to find the meaning of the relevant words and in this regard the language used and the intention of the parties must be considered. The Canadian courts have also attached an important role to the OECD commentary as part of the interpretation process. In Canada, each treaty forms part of domestic law via separate legislation, in which it is provided that the treaty will prevail over domestic legislation.

The Netherlands is a party to the Vienna Convention. The courts in the Netherlands have indicated that the OECD Commentary is of great importance in the interpretation of DTTs. In the Netherlands, a treaty becomes domestic law when it is published. Treaties will prevail over domestic law.

Thus it may be concluded that in England, Canada and the Netherlands the OECD Commentary are acknowledged as an important interpretative tool. Although South African courts have acknowledged the prominence of the OECD MTC, the Commentary is not consistently used and if it is used, the basis upon which it is used is unclear. Regarding the status of tax treaties, it is clear that tax treaties prevail over domestic legislation in Canada and the Netherlands and, generally speaking, also in the United Kingdom. Although the South African approach is not settled yet, indications are that treaties will prevail over domestic legislation.

CHAPTER 5

IS THE TRUST A PERSON FOR PURPOSES OF THE OECD MTC?

Chapter overview	124
5.1 Introduction	125
5.2 Any other body of persons	128
5.2.1 Introduction	128
5.2.2 South Africa	129
5.2.3 United Kingdom	130
5.2.4 Canada	131
5.2.5 The Netherlands	131
5.2.6 Does the context require otherwise?	132
5.3 Entity that is treated as a body corporate for tax purposes	137
5.4 Ordinary meaning of the term person	139
5.5 Trust <i>versus</i> trustee	140
5.6 Characterisation	142
5.7 Conclusion	144

5.1 Introduction

Article 1 of the OECD MTC provides that:

“This Convention shall apply to *persons* who are residents of one or both of the contracting states.” (own emphasis.)

Consequently, only “persons” may rely on the provisions of the OECD MTC⁸⁸³ and it is therefore crucial to determine whether a trust is a person for purposes of the Convention.⁸⁸⁴ A country applying the double taxation treaty (DTT) (patterned on the OECD MTC) would therefore have to determine whether the trust with which it is confronted can be regarded as a person.

Very limited case law is available on this point. In South Africa the court in *Oceanic Trust Co Ltd N.O. v Commissioner for the South African Revenue Service*⁸⁸⁵ was asked to issue a declaratory order that the relevant trust was not a resident of South Africa and did not carry on trade through a permanent establishment in South Africa. Although the treaty between South Africa and Mauritius was referred to, the question whether the relevant trust was a person under the treaty, was never addressed. In the United Kingdom case of *Wensleydale's Settlement Trustees v IRC*,⁸⁸⁶ which concerned the treaty between the United Kingdom and Ireland, the impression is gleaned that the court assumed that the trust was a person.⁸⁸⁷ The residence of a trust was discussed in *Commissioners for Her Majesty's Revenue and Customs v Smallwood*,⁸⁸⁸ but the question whether the trust is a person was never raised and one is again left with the notion that the court assumed the trust to be a person for purposes of the treaty.⁸⁸⁹ In the absence of judicial guidance on this point, the relevant provisions of the OECD MTC will be analysed and the application thereof in each of the chosen states will be discussed.⁸⁹⁰

The OECD has also provided limited guidance on the question whether a trust is a person for purposes of the OECD MTC. In its report regarding collective investment vehicles, the OECD states that:

“Under the domestic tax law of most common law countries, the trust, or the trustees, acting collectively in their capacity as such, constitutes a taxpayer. Accordingly, failing to treat such a taxpayer as a person would also prevent it from being treated as a

⁸⁸³ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 1B.01.

⁸⁸⁴ Of course a person also has to be a resident to qualify for relief in terms of the treaty. The question of residence of a trust is considered in ch 6.

⁸⁸⁵ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127.

⁸⁸⁶ *Wensleydale's Settlement Trustees v IRC* [1996] STC (SCD) 241.

⁸⁸⁷ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 1B.18 fn 5.

⁸⁸⁸ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778.

⁸⁸⁹ The question whether the trustee is a person for purposes of the treaty was specifically addressed by the Chancery Division (*Smallwood v The Commissioners for Her Majesty's Revenue and Customs* [2009] EWHC 777 (Ch)). This decision was overturned on appeal, but the Court of Appeal never explicitly addressed whether the trust or trustees were a person.

⁸⁹⁰ As explained in ch 1, the structure of this chapter will be based on the relevant provisions of the OECD MTC, with an analysis of the position in the different states provided in the conclusion.

resident despite the fact that, as a policy matter, it seems logical to treat it as a resident when the country in which it is established treats it as a taxpayer and a resident. The fact that the tax law of the country where the trust is established would treat it as a taxpayer would be indicative that the trust is a person for treaty purposes.”⁸⁹¹

The OECD does not provide any reason, based on the wording of the model, for its view. It only seems to suggest that policy and logic indicate that a trust, that is a taxpayer, should be treated as a person. The wording of the OECD MTC is examined below.

The term person is defined in the OECD MTC as follows:

“The term ‘person’ includes an individual, a company and any other body of persons.”⁸⁹²

The OECD Commentary on this definition makes it clear that the definition of person is not exhaustive and is used in a very wide sense.⁸⁹³

In turn, the term “company”, which is used in the definition of the term person, is defined as follows:

“The term ‘company’ means any body corporate or any entity that is treated as a body corporate for tax purposes.”⁸⁹⁴

According to the OECD Commentary, the tax laws of the country where the entity is organised, should be used to determine whether the entity is treated as a body corporate.⁸⁹⁵

If the above two definitions are read together, it is clear that a trust may qualify as a person if it falls within any one of the following criteria:

- (a) an individual;
- (b) any other body of persons;
- (c) a body corporate; or
- (d) any entity that is treated as a body corporate for tax purposes.

In addition, a trust may qualify as a person if it falls within the ordinary meaning of the term person.

⁸⁹¹ OECD R(24). *The granting of treaty benefits with respect to the income of collective investment vehicles* para 26. Although the report states in para 4 that only trusts that are collective investment vehicles are dealt with in the report, it is submitted that the paragraph quoted above does give an indication of the OECD’s view of trusts in general.

⁸⁹² OECD MTC art 3(1)(a).

⁸⁹³ Commentary on the OECD MTC art 3 para 2.

⁸⁹⁴ OECD MTC art 3(1)(b).

⁸⁹⁵ Commentary on the OECD MTC art 3 para 3.

Regarding item (a) above, a trust will not usually be regarded as an individual in terms of the trust laws or tax laws of each of the relevant states.⁸⁹⁶ An exception to this general statement is Canada. The Canadian Income Tax Act provides that a trust will be deemed to be an individual (barring certain exceptions).⁸⁹⁷ Therefore, although the trust is not a person under Canadian common law, it is an individual and therefore a person, in terms of the Canadian Income Tax Act.⁸⁹⁸ The term “individual” is not defined in the OECD MTC and therefore article 3(2) of the OECD MTC applies. Generally speaking, that article provides that when a country (Canada in this case) applies a treaty based on the OECD MTC and a term is not defined in the treaty, the term shall, unless the context otherwise requires, have the Canadian tax law meaning attached to it.⁸⁹⁹ Hence a trust will (unless the context requires otherwise) be regarded as a person for treaty purposes in Canada.⁹⁰⁰ Furthermore, Canada generally provides in its treaties that a trust falls within the definition of person.⁹⁰¹ Thus, in the treaties that Canada has concluded with South Africa,⁹⁰² the United Kingdom⁹⁰³ and the Netherlands,⁹⁰⁴ provision has been made in the definition of person for a trust.

In terms of item (c) above, a trust will be a person if it is a body corporate. In none of the relevant states is a trust regarded as a juristic person under the law of trusts of the specific jurisdiction.⁹⁰⁵ Hence, a trust will not be regarded as a body corporate.

Generally, a trust will therefore only be regarded as a person for purposes of the convention if it falls within any of the following three criteria (which have been renumbered for the sake of convenience):

- (a) “any other body of persons”, as set out in the definition of the term person (item (b) above);
- (b) an “entity that is treated as a body corporate for tax purposes”, as set out in the definition of company, in the country where it is organised (item (d) above); or

⁸⁹⁶ See ch 3.

⁸⁹⁷ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(2).

⁸⁹⁸ *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520 paras 10 and 13. See also ch 3.4.1.

⁸⁹⁹ See 5.2.1 for a more detailed discussion of art 3(2) of the OECD MTC.

⁹⁰⁰ Avery Jones (1989) 3 BTR 65 fn 93; Brown in *Topical Analysis* para 8.1; Tremblay and Wharram in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 14:49.

⁹⁰¹ Avery Jones (1989) 3 BTR 65 fn 93; Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* 1B.17. Brown in *Topical Analysis* para 8.1; Tremblay and Wharram in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 14:49; Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12:9. The question whether a trust is a person for treaty purposes was not discussed in *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520, as the definition of person in the relevant treaty included a trust.

⁹⁰² Convention between the Government of Canada and the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed on 27 November 1995 art 3(1)(d).

⁹⁰³ Protocol Amending the Convention Between the Government of Canada and the Government of the United Kingdom of Great Britain and Northern Ireland signed on May 7 2003 art 1.

⁹⁰⁴ Convention Between Canada and the Kingdom of the Netherlands signed on 27 May 1986, as amended art 3(1)(d).

⁹⁰⁵ See ch 2. More specifically, ch 2 gives examples, for each of the relevant jurisdictions, where trusts are *treated* as juristic persons, even though trusts are not, in law, juristic persons. It is submitted that these examples do not result in the trust being regarded as a juristic person and therefore a body corporate for purposes of the OECD MTC.

(c) a “person” in terms of the ordinary meaning of that term.

The meaning of each of these possibilities will be considered next.

5.2 Any other body of persons

5.2.1 Introduction

The words used in the definition of person are “any *other* body of persons” (own emphasis). Therefore, an entity which is either an individual or a company (as defined) cannot be a body of persons. Since the definition of company means any body corporate or any entity that is treated as a body corporate for tax purposes, the term any other body of persons must surely exclude body corporates and entities treated as body corporates for tax purposes. Therefore, an entity which is a juristic person or an entity treated as a juristic person for tax purposes, will not be a body of persons. Trusts do not have juristic personality in any of the states relevant to this dissertation and therefore trusts will not be barred from being regarded as a body of persons in this regard. The meaning of the term “entity treated as a body corporate for tax purposes” is discussed below, but if a trust is regarded as such an entity, it will not be a body of persons.

The term⁹⁰⁶ body of persons is not defined in the OECD MTC. Thus, article 3(2) of the OECD MTC⁹⁰⁷ becomes relevant. This provision states that:

“As regards the application of the convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at the time under the law of that State for the purpose of the taxes to which the convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.”

Thus, unless the context otherwise requires, it is the laws of the relevant states that will determine the meaning of the term body of persons. The article suggests that not only the tax law meaning of the term should be taken into account, but also any other domestic law meaning(s) of the term. Where, however, there are different meanings attached to a term, the meaning under the tax laws, to which the treaty applies, should, arguably, prevail.⁹⁰⁸ A description of the meaning of the term in the domestic laws of the relevant states is given in the next paragraph. Whether the “context requires” that a meaning other than the domestic law meaning is used, is discussed in a later paragraph.⁹⁰⁹

⁹⁰⁶ In this dissertation the word “term” is used to refer to the words “body of persons”. The word term was chosen over other possibilities such as “phrase” or “concept”, since art 3(2) of the OECD MTC uses the word term and since the words body of persons is defined in the United Kingdom and is therefore a term in that state. In order to be consistent, the word term was therefore used throughout the chapter.

⁹⁰⁷ Other issues that may be relevant in the interpretation of art 3(2) of the OECD MTC include whether the statutory or ambulatory approach should be followed and which state’s laws are to be applied. These issues will not be addressed in detail in this dissertation. Reference will be made in passing to these issues in other chapters.

⁹⁰⁸ Commentary on the OECD MTC art 3 para 13.1; Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para E.22.

⁹⁰⁹ See para 5.2.6 below.

5.2.2 South Africa

In South Africa the term body of persons is not defined in the Income Tax Act,⁹¹⁰ but the term has been dealt with in numerous tax cases.

In *ITC 227*⁹¹¹ the court had to decide whether a club could be regarded as a separate taxable entity. At that stage the relevant legislation's definition of the term person included "any *body of persons* corporated or unincorporated" (own emphasis). The court held the club to be a body of persons, stating that

"[i]t consists of a number of persons partly described as proprietary and partly as non-proprietary members, associated together for certain purposes. These persons have common interests and act in common, asserting their voice by means of meetings and a majority vote of members, being represented for administrative purposes by the Stewards. In this respect they constitute an association, that is to say, a body of persons associated together for some common object or purpose. They accordingly fall within the definition of 'person'..."⁹¹²

In *Commissioner for Inland Revenue v Witwatersrand Association of Racing Clubs*⁹¹³ it was contended that the relevant association was not a taxable entity. The applicable income tax legislation contained no definition of the term person, but in terms of the then applicable Interpretation Act⁹¹⁴ a person included, *inter alia*, "any body of persons corporate or unincorporated". The issue before the court was whether the relevant association was a body of persons unincorporated. In this regard the court held that a body of persons unincorporated means "an association of persons which does not have a legal *persona* separate from its constituent members".⁹¹⁵

However, in *Commissioner for Inland Revenue v Friedman and Others NNO*⁹¹⁶ it was specifically held that a trust did not constitute a body of persons unincorporated whose common funds are the collective property of all its members, as referred to in the current Interpretation Act.⁹¹⁷ Hence a trust was not a person for purposes of the Income Tax Act.⁹¹⁸ Even though the word "unincorporated" formed part of the term interpreted by the court (that is, "body of persons unincorporated"), it is submitted that the addition of that word is not decisive.

⁹¹⁰ Income Tax Act 58 of 1962. The term body of persons is used in a number of places in the Income Tax Act (eg the definition of "agent" in s 1, the definition of "date of grant" in s 8B and the definition of "date of distribution" Sch 8, para 74), but is never defined.

⁹¹¹ *ITC 227* (1931) 6 SATC 234 (U).

⁹¹² *ITC 227* (1931) 6 SATC 234 (U) 238–239.

⁹¹³ *Commissioner for Inland Revenue v Witwatersrand Association of Racing Clubs* 1960 3 SA 291 (A).

⁹¹⁴ Interpretation Act 5 of 1910.

⁹¹⁵ *Commissioner for Inland Revenue v Witwatersrand Association of Racing Clubs* 1960 3 SA 291 (A) 302.

⁹¹⁶ *Commissioner for Inland Revenue v Friedman and Others NNO* 1993 1 SA 353 (A).

⁹¹⁷ Interpretation Act 33 of 1957. The wording of this Act is exactly the same as that of the Interpretation Act 5 of 1910.

⁹¹⁸ *Commissioner for Inland Revenue v Friedman and Others NNO* 1993 1 SA 353 (A) 370. The Income Tax Act was amended to include a trust in the definition of person in s 1 of the Income Tax Act as a consequence of the *Friedman* case.

Thus it is clear that for South African tax law purposes a trust is not a body of persons. Hence, if South African law is applicable, in terms of article 3(2) of the OECD MTC, a trust would not be regarded as a body of persons. Below the question is addressed whether the context requires that South African law is not applicable and possible meanings other than the South African domestic law meaning of the term is suggested.

5.2.3 United Kingdom

In the United Kingdom, the Income Tax Act⁹¹⁹ contains a definition of the term body of persons, namely:

“‘body of persons’ means any body politic, corporate or collegiate and any company, fraternity, fellowship and society of persons whether corporate or not corporate.”⁹²⁰

The Interpretation Act,⁹²¹ which applies to all legislation, including tax legislation,⁹²² does not contain a definition of the term body of persons. It does, however, define the term person as follows:

“‘Person’ includes a body of persons corporate or unincorporated.”

According to Avery Jones, the definition of person in the Interpretation Act “impliedly gives a more general meaning to that expression [body of persons], by including anything which may be described as a body of persons, whether or not incorporated.”⁹²³ Avery Jones opines that although there is no authority on whether *trustees* are included in the Interpretation Act meaning of body of persons, there seems no reason why trustees should not be regarded as such.⁹²⁴

Avery Jones, commenting on a previous version of the Income Tax Act, but on a definition that is identical to the one contained in the Income Tax Act 2007, is of the view that *trustees* are not a “body of persons” for purposes of the Income Tax Act.⁹²⁵ It is submitted that the same would hold true for a trust.

However, the Income Tax Act 2007 now contains the following provision:

“For the purposes of the Income Tax Acts (except where the context otherwise requires), the trustees of a settlement are together treated as if they were a single person (distinct from the persons who are the trustees of the settlement from time to time).”⁹²⁶

⁹¹⁹ Income Tax Act 2007.

⁹²⁰ Income Tax Act 2007 s 989.

⁹²¹ Interpretation Act 1978.

⁹²² S 5 of the Interpretation Act 1978 provides that “[in] any Act, unless the contrary intention appears, words and expressions listed in Schedule 1 to this Act are to be construed according to that Schedule”.

⁹²³ Avery Jones (1991) 11/12 *BTR* 453 458.

⁹²⁴ Avery Jones (1991) 11/12 *BTR* 453 459.

⁹²⁵ Avery Jones (1991) 11/12 *BTR* 453 461.

⁹²⁶ Income Tax Act 2007 s 474(1).

Under the 2007 legislation, the *trustees* are a body of persons,⁹²⁷ by virtue of the trustees being treated as if they were a single person. The trustees, as a single person, are regarded as distinct from the persons who act as trustees⁹²⁸ The single person is therefore treated as distinct from the individual(s) or company(ies) who are the trustees, acting in their private capacity.⁹²⁹ Furthermore, there is a case that suggests that trustees are a body of persons.⁹³⁰ One is also left with the impression in the *Smallwood*-case⁹³¹ that the trustees are regarded as a body of persons, although this point was never explicitly addressed by the court.⁹³² However, the position of the trust itself is not addressed in any of these sources and it is submitted that, based on the formulation of the Income Tax Act, the trust will not be regarded as a body of persons.

5.2.4 Canada

The term body of persons is not defined in the Canadian Income Tax Act.⁹³³ The author has been unable to find case law which indicates the meaning of the term body of persons for purposes of Canadian income tax law. The question whether a trust is a body of persons therefore does not seem to crop up in Canadian law. Two possible reasons in relation to DTTs may be submitted. First, as stated above, the Canadian Income Tax Act provides that a trust will be deemed to be an individual (and hence a trust will be regarded as a person for treaty purposes in Canada). An entity which is an individual cannot be a body of persons.⁹³⁴ Second, as stated above, Canada generally provides in its treaties that a trust falls within the definition of person.⁹³⁵ Thus, it is unnecessary to determine whether a trust is a body of persons for treaty purposes.

5.2.5 The Netherlands

Since 2010, the *Wet inkomstenbelasting 2001* creates the concept of the *afgezonderd particulier vermogen* (APV).⁹³⁶ Although the definition of an APV is vague and broad, many trusts, especially discretionary trusts, will be regarded as APV's, which, generally speaking,

⁹²⁷ Cleave, commenting on a fairly similar provision in respect of capital gains, states that the relevant section was "statutory confirmation that trustees are a 'body of persons' and thus qualified as a 'person' under Article 3(1) of the Model" (Cleave (2011) 6 *BTR* 705 708).

⁹²⁸ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 230.

⁹²⁹ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 229.

⁹³⁰ *Reid's Trustee v IRC* 14 TC 512.

⁹³¹ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 para 69.

⁹³² The Chancery Division specifically decided that "the trustee or trustees of the Smallwood settlement are treated as a person within the meaning of the Convention" (*Smallwood v The Commissioners for Her Majesty's Revenue and Customs* [2009] EWHC 777 (Ch) para 9). This decision was based on wording fairly similar to that contained in the Income Tax Act 2007 s 474(1). Although the decision was overturned on appeal, the Court of Appeal did not pronounce explicitly on the question whether the trust or trustee is to be regarded as a person.

⁹³³ RS 1985 c 1 (5th suppl).

⁹³⁴ See 5.2.1.

⁹³⁵ Avery Jones (1989) 3 *BTR* 65 fn 93; Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* 1B.17. The question whether a trust is a person for treaty purposes was not discussed in *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520, as the definition of person in the relevant treaty included a trust and the case primarily dealt with the Canadian domestic law rule regarding the residence of a trust. During the course of the judgment, the court confirmed that, for domestic purposes, a trust is an individual and also a person.

⁹³⁶ *Wet inkomstenbelasting 2001* s 2.14a, effective from January 2010. The taxation of trusts in the Netherlands, including the APV regime, is discussed in greater detail in ch 3.5.

means that the income is attributed to the settlor. It is submitted that the APV is a concept for Netherlands tax purposes only and that it does not create a new entity as such. Consequently, it is unnecessary to determine whether an APV will be regarded as a person for purposes of the OECD MTC. The question remains whether the trust itself (which may be an APV for domestic Netherlands tax law) will be regarded as a person. This paragraph therefore considers whether a trust will be regarded as a body of persons.

Some authors are of the view that the term *vereniging van personen* (body of persons) implies a non-profit organization, which is also used in non-tax law.⁹³⁷ Others are of the view that the term is not limited to non-profit organisations and that it includes *ieder samenwerkingsverband van personen* (every collaboration of persons) and that the term *personen* refers not only to natural persons, but also to companies.⁹³⁸ The term *vereniging van personen* is also used where the OECD MTC uses the term “association” in the definition of “national”.⁹³⁹ The term *vereniging van personen* is not found in the *Wet inkomstenbelasting*⁹⁴⁰ or the *Wet op de vennootschapsbelasting*.⁹⁴¹ It is submitted that a trust will not be regarded as a *vereniging van personen*.⁹⁴² The reason for this view is that a trust will be formed and governed by the law of a jurisdiction other than the Netherlands and such a jurisdiction will determine its nature. In terms of the law of the jurisdictions referred to in this dissertation, a trust is not regarded as a body of persons. The trustees of a trust might, however, be regarded as a *vereniging van personen* in the wide sense described above.

5.2.6 Does the context require otherwise?⁹⁴³

Stated briefly, under article 3(2) of the OECD MTC, an undefined term shall have the meaning that it has under the laws of the relevant state, unless the context otherwise requires.

In determining whether the context requires otherwise, one should establish what is meant by the term “context”. Avery Jones *et al* have written extensively on this subject, concluding that there are two approaches to the meaning of context. The first is that

“one starts with the a narrow meaning of context, essentially the internal context, which is used to interpret a treaty in conjunction with other factors, such as the object and purpose of the treaty, subsequent agreement and practice, supplementary means of interpretation, and in some cases the text in other official language.”

The second is that any type of material which can properly be described as context may be considered. The authors concede that in practice there may be very little difference in the results of these approaches.⁹⁴⁴

⁹³⁷ Avery Jones *et al* (2006) 60 *BFIT* 220 222.

⁹³⁸ Anonymous in *Nederlandse Regelingen van Internationale Belastingrecht* IB–276.

⁹³⁹ Avery Jones *et al* (2006) 60 *BFIT* 220 222.

⁹⁴⁰ *Wet inkomstenbelasting* 2001.

⁹⁴¹ *Wet op de vennootschapsbelasting* 1969.

⁹⁴² Anonymous in *Nederlandse Regelingen van Internationale Belastingrecht* IB–276.

⁹⁴³ Due to the Canadian position on “body of persons” it is not necessary to discuss whether the context requires otherwise in relation to Canada.

Other authors agree that the “context” should be given a wide interpretation and not be limited to the narrow definition of context in the Vienna Convention⁹⁴⁵ (in other words, the text of the treaty, its preamble and annexes and agreements in connection with the treaty).⁹⁴⁶

The OECD’s commentary provides as follows regarding the meaning of “context”:

“The context is determined in particular by the intention of the Contracting States when signing the Convention as well as the meaning given to the term in question in the legislation of the other Contracting State (an implicit reference to the principle of reciprocity on which the Convention is based).”⁹⁴⁷

According to Avery Jones *et al*, the indications from the context must be reasonably strong for the domestic law meaning to be disregarded.⁹⁴⁸ Sada Garibay is of the view that courts, internationally, will conclude that the context requires that a meaning other than the domestic law meaning be used in the following circumstances:

- (a) If the result of applying the domestic meaning would be contrary to the intention of the parties to the treaty. The intention of the parties may be established by referring to the treaty text, the opinion of an expert who participated in the treaty negotiation, extrinsic materials (without a clarification of the meaning of this term), *travaux préparatoires*, domestic law, the Commentary on the OECD Model, the non-inclusion of a specific alternative provision established in Commentary and records relating to the discussions between the treaty parties, as well as the speeches of the relevant Ministers, the preamble to the DTT, press releases and even the interpretation of the treaty partner.
- (b) If the literal meaning clashes with the object or purpose of the DTT.
- (c) If the existing Commentary on the OECD Model contained a definition at the time that the DTT was signed and the parties did not provide differently.
- (d) If the treaty benefits would have been granted in abusive situations.⁹⁴⁹

But what meaning should be attached to a term if the domestic law meaning is not used?⁹⁵⁰ Some authors suggest that the ordinary or natural meaning⁹⁵¹ should be used, while others suggest that an international fiscal meaning should be applied.⁹⁵²

⁹⁴⁴ Avery Jones *et al* (1984) 1 BTR 90 104.

⁹⁴⁵ Vienna Convention on the Law of Treaties 1969 art 31(2).

⁹⁴⁶ Vogel *et al* Klaus Vogel on Double Taxation Conventions 214; Baker Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital para E.20; Sada Garibay (2011) 65 *An Analysis of the Case Law on Article 3(2) of the OECD Model (2010)* para 9.

⁹⁴⁷ Commentary on the OECD MTC art 3 para 12.

⁹⁴⁸ Avery Jones *et al* (1984) 1 BTR 90 108; See also Vogel *et al* Klaus Vogel on Double Taxation Conventions 215.

⁹⁴⁹ Sada Garibay (2011) 65 *An Analysis of the Case Law on Article 3(2) of the OECD Model (2010)* para 7.

⁹⁵⁰ Baker Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital para E.20.

In the recent South African case of *Commissioner for the South African Revenue Service v Tradehold Ltd*,⁹⁵³ the Supreme Court of Appeal was asked to apply article 3(2) of the relevant DTT, which corresponds to article 3(2) of the OECD MTC. In this case the meaning of the term “alienation”, in article 13(4) of the relevant treaty, which deals with capital gains, was considered. Paragraphs 12(1) and (2) of the Eighth Schedule to the Income Tax Act provides for a deemed disposal of certain property and the question before the court was whether the deemed disposal could be regarded as an alienation within the meaning of art 13(4). The term alienation is undefined in the relevant treaty (and in the OECD MTC) and thus the court was asked to apply article 3(2) of the relevant treaty to interpret the term in accordance with the South African law meaning of that term. The South African Revenue Service argued that in terms of the South African law meaning of the term alienation, a deemed disposal cannot be regarded as an alienation.⁹⁵⁴

Although the court held that article 3(2) applied,⁹⁵⁵ the court did not use the South African law meaning of the term alienation, but failed to explain why. The court held that the term “must be given a meaning that is congruent with the language of the DTA having regard to its object and purpose”.⁹⁵⁶ It further stated that article 13 is widely cast and that the parties intended that article 13 apply to the type of capital gain provided for in paragraph 12 of the Eighth Schedule. More specifically, the court held that “the term ‘alienation’ as it is used in the DTA is not restricted to actual alienation. It is a neutral term having a broader meaning, comprehending both actual and deemed disposals of assets giving rise to taxable capital gains”.⁹⁵⁷

It is submitted that one can deduce from the case that the court applied article 3(2) to the term alienation, but, although the court never expressly stated this, held that the “context requires otherwise”.⁹⁵⁸ In other words, it is inferred that the context required that the South

⁹⁵¹ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para E.20; Brincker in *Silke on International Tax* para 16.12; Sada Garibay (2011) 65 *An Analysis of the Case Law on Article 3(2) of the OECD Model* (2010) 8.

⁹⁵² Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para E.20.

⁹⁵³ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

⁹⁵⁴ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 13.

⁹⁵⁵ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 19. The case may be criticised on a number of points, one of which includes the court’s failure to address the provisions Income Tax Act 58 of 1962 Sch 8 para 13. For a debate on this point of criticism see Emslie (2012) 61 *The Taxpayer* 92 92; Anonymous (2012) 61 *The Taxpayer* 121 121; Classen (2013) 25 *SA Merc LJ* 387; and Seiler (2013) 67 *BFIT* 580. Other points of criticism are addressed in other chapters of this dissertation, eg paras 4.3.2.2 and 4.4.1.

⁹⁵⁶ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 23.

⁹⁵⁷ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 25.

⁹⁵⁸ It is regrettable that the court did not expressly pronounce on this issue. It would have been invaluable to have the court’s views on the meaning of context and a firm indication of the circumstances under which it would disregard the South African domestic law meaning of a term. Because the court failed to give reasons why it did not apply the South African meaning of the word alienation, one is left with the task of inferring what the court meant, a task bordering on speculation. With so little case law dealing with the interpretation of DTTs in South Africa, the lack of guidance on this important issue is disappointing. It is also possible to argue that the court did not (tacitly) hold that the context requires that the South African meaning of the term alienation should not be used, but rather that the court did apply the South African meaning of the term, but not the meaning argued for by SARS. This would mean that the court in effect found that the South African law

African law meaning of the word be disregarded. But what meaning did the court use instead?

Earlier on in its judgement the court observed that the relevant DTT was based on the OECD MTC. It held that when interpreting the provisions of a DTT there will not be an exact correlation between the wording of the treaty and that used in the domestic legislation. The wording used in model-based treaties is wide in nature and intended to encompass the various taxes generally found in the OECD member countries. Also, for other reasons mentioned in the case, “the wording in the DTA cannot be expected to match precisely that used in the domestic taxing statute”.⁹⁵⁹ The court then referred to the *Downing* case in which the concept of “international tax language” was used.⁹⁶⁰

It is submitted that, arguably, the Supreme Court of Appeal has indicated a preference for the international fiscal meaning of a term, rather than the ordinary meaning of the term, if, in terms of article 3(2), the context requires that the domestic law meaning of the term be disregarded.

In the United Kingdom, case law suggests that the ordinary meaning of the term body of persons should be used in a case where the context requires that the domestic law meaning be disregarded. In *Padmore v Commissioners of Inland Revenue*⁹⁶¹ the relevant DTT defined the term person as including “any body of persons, corporate or not corporate”. It was argued that, by virtue of a provision similar to article 3(2), since the term body of persons was undefined in the relevant treaty, the definition under United Kingdom tax law (a definition in the same terms as the one contained in the Income Tax Act 2007 which was quoted above) was applicable. The court held that the United Kingdom tax law definition was not applicable, since the words “corporate or not corporate” in the definition of person would have been unnecessary if the intention was for the United Kingdom tax law definition, which also contains these words, to apply. Furthermore, the court, having assumed that a partnership (the relevant entity in the case) was not covered by the definition in the United Kingdom tax law, held that it was highly improbable that the intention was to exclude a partnership from the definition of person, since a partnership was such a commonly used vehicle for commercial activity. Applying the ordinary meaning of the term body of persons, the court held that a partnership was plainly a body of persons.

The OECD MTC uses a different wording in its definition of person as the applicable treaty did in *Padmore*, so the first argument will not extend to the OECD MTC.⁹⁶² The second argument, namely that it was unlikely that the intention was to exclude a commonly used vehicle, would, however, equally apply to trusts. Based on this argument, the Income Tax Act 2007 definition of body of persons would not be used but rather the ordinary meaning of the term. Under such a meaning it is unlikely that *trustees* would not be regarded as a person.⁹⁶³ Avery Jones *et al* state that “[t]he internal tax law meaning...is almost certainly not intended

meaning of the term did not have the narrow meaning contended for by SARS, but that the term included deemed disposals in terms of South African law.

⁹⁵⁹ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 18.

⁹⁶⁰ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 18.

⁹⁶¹ *Padmore v The Commissioners of Inland Revenue* [1989] STC 493.

⁹⁶² Avery Jones (1991) 11/12 BTR 453 464.

⁹⁶³ Avery Jones (1989) 3 BTR 65 fn 91.

to be incorporated into treaties, a case of the context otherwise requiring".⁹⁶⁴ Would a trust (as opposed to the trustees) be regarded as a body of persons under the ordinary meaning of the term? It is submitted that, given the nature of a trust in both England and Scotland,⁹⁶⁵ a trust will not be regarded as a body of persons.⁹⁶⁶

In South Africa, if an argument similar to the second one in *Padmore* is followed, one would be able to contend that the domestic law meaning of the term, as enunciated in the *Friedman*-case (which states that a trust is not a body of persons), should be ignored. Then the ordinary meaning of the term should be applied, since it is unlikely that the intention was to exclude a commonly used vehicle such as a trust. Given the nature of a trust,⁹⁶⁷ it is submitted that a South African trust will not, in the ordinary meaning of the term, be regarded as a body of persons. The nature of a trust (subject to all the detail and qualifications discussed elsewhere⁹⁶⁸) is that it is a *sui generis* institution in which a trustee holds property for the benefit of another or for a specific purpose. It is submitted that such an institution cannot be described as a body of persons.⁹⁶⁹ The trustees or the beneficiaries may arguably be a body of persons, but not the trust itself.⁹⁷⁰

Since a trust cannot be formed in terms of Dutch law, another jurisdiction's law will have to be applied to determine the nature of a trust. If a trust is formed in any of the jurisdictions considered in this dissertation, it is submitted that a trust will not be regarded as a body of persons, because of the nature of the trust.⁹⁷¹ Arguably, the trustees of a trust may be a body of persons within its ordinary meaning.

If an international fiscal meaning for the term body of persons were to be applied, one would have to establish what such meaning is. As pointed out by Vogel,⁹⁷² this is a difficult task and it is with hesitance that an interpretation is offered below. The term body of persons was first used in the OECD MTC in its 1963 draft, although it was used earlier in some treaties entered into by the United Kingdom.⁹⁷³ It is not suggested, however, that the term, as it was used the United Kingdom at the time, was incorporated in the OECD MTC.⁹⁷⁴

In its deliberations regarding the amendment of the definition of person, Working Party 14 of the Fiscal Committee considered that the term body of persons includes:

- (a) bodies of persons which are not treated as taxable units under the tax laws of any of the contracting states;
- (b) bodies of persons which are taxable units under the tax laws of any of the contracting states and treated in exactly the same way as juristic persons; and

⁹⁶⁴ Avery Jones *et al* (2006) 60 *BFIT* 220 222.

⁹⁶⁵ See ch 2.3.3.

⁹⁶⁶ Cf Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12:9.

⁹⁶⁷ See ch 2.2.4.

⁹⁶⁸ See ch 2.2.4.

⁹⁶⁹ Cf Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12:9.

⁹⁷⁰ For a contrary view see Honiball and Olivier *The Taxation of Trusts in South Africa* 285.

⁹⁷¹ Cf Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12:9.

⁹⁷² Vogel *et al* Klaus Vogel on *Double Taxation Conventions* 58.

⁹⁷³ Avery Jones *et al* (2006) 60 *BFIT* 220 223.

⁹⁷⁴ Avery Jones *et al* (2006) 60 *BFIT* 220 222.

- (c) bodies of persons which are taxable units under the tax laws of any of the contracting states, but which are not treated in the same way as juristic persons.⁹⁷⁵

The Working Party considered it advisable that the term should include all three of the categories set out above, stating that countries were free in bi-lateral negotiations to eliminate problems arising from the differences in their tax systems due to the broad definition of person and to exclude entities if they thought it desirable.⁹⁷⁶ Thus it may be deduced that the OECD MTC includes all three of the categories listed above in the phrase body of persons.⁹⁷⁷

However, bearing in mind that the wording of the definition is “any *other* body of persons” (own emphasis), the point raised earlier should be considered, namely that if an entity is an individual or a company (including an entity that is treated as a body corporate for tax purposes), it will not be regarded as a body of persons for purposes of the treaty. It is therefore necessary to determine the meaning of the phrase “entity that is treated as a body corporate for tax purposes” and this will be done in the next paragraph. The view taken there is that the phrase “entity that is treated as a body corporate for tax purposes” refers only to item (b) above, namely taxable units under the tax laws of any of the contracting states and treated in exactly the same way as juristic persons. It is therefore submitted that an international fiscal meaning of “body of persons” denotes only items (a) and (c) listed above.

In South Africa, trusts are, at least sometimes, treated as taxable units (but not in the same way as juristic persons)⁹⁷⁸ and could therefore, potentially, fall within item (c). Even if trusts were treated as transparent (which they sometimes are), trusts could fall within item (a) above. If the suggested international fiscal meaning of “body of persons” were used, a trust may potentially qualify as such. However, items (a) and (c) still refer to “bodies of persons” and one would therefore have to overcome the argument made above that a trust is not a body of persons within the ordinary meaning of that term. All in all, arguing that a trust is a person because it falls within the international fiscal meaning of the term, suggesting an international fiscal meaning and arguing that the trust is indeed covered by that meaning, cannot be done with much confidence. It is submitted that the same would hold true for the United Kingdom and the Netherlands.

5.3 Entity that is treated as a body corporate for tax purposes

The OECD’s Commentary on the meaning of the relevant phrase is not very illuminating. It merely states that:

⁹⁷⁵ Organisation for European Economic Co-operation *Working Party no 14 of the Fiscal Committee Second Report on the Article on Definitions* 2–3. The OEEC is the predecessor to the OECD.

⁹⁷⁶ OECD *Working Party No 14 of the Fiscal Committee Third Report on the Article on Definitions* 5.

⁹⁷⁷ This argument is based on the premise that a court will, in interpreting an actual treaty, consider the meaning of the provisions of the OECD MTC and that the deliberations of the Working Party will be considered relevant and authoritative in this regard.

⁹⁷⁸ See ch 3.2.2.

“In addition the term covers any other taxable unit that is treated as a body corporate according to the tax laws of the Contracting State in which it is organised.”⁹⁷⁹

What the Commentary does add, is that the tax laws of the Contracting State in which the taxable unit is organised, should be applied to determine whether the entity is treated as a body corporate. Avery Jones *et al* criticise the wording of the Commentary, saying that the state in which the entity is organised should be irrelevant and that the tax laws of the state in which the entity is resident should rather be used to determine whether it is treated as a body corporate. These authors call for the amendment of the Commentary to reflect that the tax laws of the residence state of the taxable unit should be used to determine whether it is treated as a body corporate.⁹⁸⁰

Avery Jones *et al* further state that only entities that are treated like juristic persons under the tax laws of any of the contracting states (that is, item (b) of Working Party 14’s list of entities included as a body of persons)⁹⁸¹ are included in the phrase “entity that is treated as a body corporate for tax purposes”. In other words, entities not treated as taxable units and entities treated as taxable units, but which are not treated in the same way as juristic persons under the tax laws of any of the contracting states (that is items (a) and (c) of Working Party 14’s list of entities included as body of persons), are not to be regarded as entities that are treated as a body corporate for tax purposes.⁹⁸²

In South Africa, trusts are, generally speaking, taxed in terms of a specific section of the Income Tax Act and at a rate which differs from that of companies.⁹⁸³ A trust is therefore not subject to the same tax regime as a juristic person and will therefore not be regarded as an “entity that is treated as a body corporate for tax purposes” in terms of South African tax laws.

In the United Kingdom, generally speaking, trusts and companies are taxed in terms of different statutes and at different rates.⁹⁸⁴ Trusts and companies are therefore not subject to the same tax regime and, consequently, a trust will not be regarded as an “entity that is treated as a body corporate for tax purposes” in terms of United Kingdom tax laws.

In Canada trusts are treated as individuals for federal income tax purposes.⁹⁸⁵ Generally speaking, *inter vivos* trusts are taxed at the top marginal rate of income tax on their undistributed income,⁹⁸⁶ while testamentary trusts are taxed at the same tax rates as individuals.⁹⁸⁷ There are also specific sections in the federal legislation dealing with the

⁹⁷⁹ Commentary on the OECD MTC art 3 para 3.

⁹⁸⁰ Avery Jones *et al* (2009) 4 *BTR* 406 413.

⁹⁸¹ See ch 5.2.6.

⁹⁸² Avery Jones *et al* (2009) 4 *BTR* 406 412.

⁹⁸³ Income Tax Act 58 of 1962 s 25B. Trusts other than special trusts (see ch 1) are taxed at a rate of 40%, while companies are, generally speaking, taxed at a rate of 28%. See also ch 3.2.

⁹⁸⁴ Eg companies may be taxed in terms of the Corporation Tax Act 2009 and trusts in terms of the Income Tax Act 2007 part 9 ch 3 or the Income Tax (Trading and Other Income) Act 2005. Scottish trusts are taxed in terms of the same regime as other trusts in the United Kingdom. (Garden and Mackintosh *Trusts and Estates in Scotland 2009/2010* 37 and further.) See also ch 3.3.

⁹⁸⁵ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(2).

⁹⁸⁶ Anonymous *Canadian Master Tax Guide* para 7280; Income Tax Act RSC 1985 (5th supp) ch 1 s 122(1)(a).

⁹⁸⁷ Income Tax Act RSC 1985 (5th supp) ch 1 s 117(2).

taxation of trusts.⁹⁸⁸ Generally speaking, corporations are subject to tax at a flat rate at federal level.⁹⁸⁹ The same tax regime therefore does not apply to trusts and companies and therefore a trust is not an “entity that is treated as a body corporate for tax purposes” in terms of federal Canadian tax laws.⁹⁹⁰

In the Netherlands some trusts will be treated as APV’s, which, generally speaking, means that the income is attributed to the settlor.⁹⁹¹ Companies are taxed in terms of the *Wet op de vennootschapsbelasting 1969*. Some non-resident trusts will qualify as doelvermogens (purpose funds), which would mean that they will be subject to corporate income tax under the *Wet op de vennootschapsbelasting 1969* in respect of their Dutch income. To the extent that a trust can be resident in the Netherlands, these trusts are not subject to tax in terms of the *Wet op de vennootschapsbelasting 1969*.⁹⁹² Therefore, while some trusts are not subject to the same tax regime as companies and will therefore not qualify as an “entity that is treated as a body corporate for tax purposes” in terms of the tax laws of the Netherlands, a few others will.

5.4 Ordinary meaning of the term person

The OECD’s commentary on the definition of person states, *inter alia*, the following:

“The definition of the term “person”... is not exhaustive and should be read as indicating that the term “person” is used in a very wide sense (especially Articles 1 and 4).”⁹⁹³

In addition, the definition of the term person uses the word “includes” and not “means”. According to Avery Jones *et al*:

“When a treaty partially defines a term by saying that it “includes” certain things, Article 3(2) can still be applied to complete the definition of the term.”⁹⁹⁴

It has therefore been suggested that the ordinary meaning of a term may be used to interpret that term, where the word includes is used in the definition of the term.⁹⁹⁵ In other words, the words of inclusion (“an individual, a company and any other body of persons”) are not used to interpret the term person, but rather its ordinary meaning.

In South Africa and directly as a result of the *Friedman* case,⁹⁹⁶ which held that a trust was not a person for income tax purposes and therefore not taxable, the definition of the term

⁹⁸⁸ Eg Income Tax Act RSC 1985 (5th supp) ch 1 s 104. See also ch 3.4.

⁹⁸⁹ Dwyer (2011) *Country Analyses IBFD* para 1.10.1.1.

⁹⁹⁰ Publicly traded income trusts formed after 31 October 2006 (also known as “SIFT trusts” may be an exception, as they are taxed as if they were corporations (Dwyer (2011) *Country Analyses IBFD* 11.6.2.4; Anonymous *Canadian Master Tax Guide* para 7282).

⁹⁹¹ See ch 3.5.

⁹⁹² See ch 3.5.2. Although it is highly unlikely that a trust will be resident in the Netherlands (see ch 6.3.4).

⁹⁹³ Commentary on the OECD MTC art 3 para 2.

⁹⁹⁴ Avery Jones *et al* (1984) 1 *BTR* 14 21.

⁹⁹⁵ Avery Jones (1989) 3 *BTR* 65 fn 91.

⁹⁹⁶ *Commissioner for Inland Revenue v Friedman and Others NNO* 1993 1 SA 353 (A).

“person” in the Income Tax Act was amended and now includes a trust.⁹⁹⁷ Hence, a trust is a person for domestic income tax purposes.

Using this domestic law definition to complete the treaty definition of the term person, as suggested by Avery Jones *et al*, it is submitted that a trust will be regarded as a person for treaty purposes.⁹⁹⁸

One could be tempted to argue that, because a trust is regarded by some as a separate entity (although not a juristic person),⁹⁹⁹ it will be regarded as a person within the ordinary meaning of that word. However, in *Commissioner for Inland Revenue v MacNeillie's Estate*¹⁰⁰⁰ and the *Friedman* case¹⁰⁰¹ it was held that a trust is not a person.

It may therefore be concluded that if the Income Tax Act did not define the trust as a person for South African domestic tax purposes, the trust would not have been regarded as a person in terms of the OECD MTC.

In the United Kingdom, the Income Tax Act 2007 contains no definition of the term person. However, the Interpretation Act does stipulate that a person includes “a body of persons corporate or unincorporated”. It has been argued above that a trust is not a body of persons in the United Kingdom. It is therefore submitted that a trust will not qualify as person in terms of the definition of person in the Interpretation Act. It is worth noting that on fairly similar wording in the South African Interpretation Act, a South African court has held that a trust is not a person. Bearing in mind the legal nature of a trust in the United Kingdom,¹⁰⁰² it is submitted that a trust will not be regarded as a person.¹⁰⁰³

Since a trust is deemed to be an individual in Canada, it is unnecessary to argue whether a trust will be regarded as a person under its ordinary meaning.

5.5 Trust *versus* trustee

In the above paragraphs it was considered whether a *trust* is a person for purposes of article 1 of the OECD MTC. Some argue that this may not be a decisive question since the *trustee(s)* will usually be regarded as a person(s).¹⁰⁰⁴ Using the same criteria derived from the wording of the OECD MTC and set out above, this paragraph will consider whether the trustee(s) of a trust will be regarded as a person.

⁹⁹⁷ Income Tax Act 58 of 1962 s 1.

⁹⁹⁸ See also Honiball and Olivier *The Taxation of Trusts in South Africa* 285.

⁹⁹⁹ See ch 2.2.4.

¹⁰⁰⁰ *Commissioner for Inland Revenue v MacNeillie's Estate* 1961 3 SA 833 (A) 840.

¹⁰⁰¹ *Commissioner for Inland Revenue v Friedman and Others* NNO 1993 1 SA 353 (A) 370.

¹⁰⁰² See ch 2.3.3.

¹⁰⁰³ See Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 230, who emphaticall states that a trust is not a person in English law. However, he argues further that this point is not insuperable as treaties can be loosely construed. Under such a construction it could be argued that a trust is a person (in the treaty sense) even though not a person in English law. But he argues that there is no need to follow this course.

¹⁰⁰⁴ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 1B.20.

In South Africa, the domestic tax law meaning of the term body of persons is “an association of persons which does not have a legal *persona* separate from its constituent members”.¹⁰⁰⁵ It is submitted that trustees of a trust may fall within this definition and thus qualify as a body of persons. If the context requires that the domestic law meaning of the term be disregarded and the ordinary meaning of the term be used, it is submitted that the trustees will be considered a body of persons. Furthermore, it is submitted that the trustee(s) of a trust will be regarded as a person within the ordinary meaning of that word.¹⁰⁰⁶ Thus, a trustee(s) will be regarded as a “person” for purposes of the OECD MTC from a South African perspective.

In the United Kingdom, if the domestic law meaning of the term body of persons is used, the trustees of a trust will be regarded as such, because of the amended wording of the Income Tax Act 2007. Furthermore, if the domestic law meaning of the term “body of persons” is disregarded and the ordinary meaning of the term is used, the trustees of a trust will be regarded as a body of persons. In terms of the ordinary meaning of the term “person”, the trustees will be regarded as a “person”.¹⁰⁰⁷ Therefore, the trustees of a trust will be regarded as a “person” for purposes of the OECD MTC in the United Kingdom.

In Canada the Income Tax Act provides that a reference to a trust shall, unless the context otherwise requires, be read to include a reference to the trustee.¹⁰⁰⁸ Thus, a trustee will be regarded as a person for purposes of the OECD MTC on the same basis as a trust.¹⁰⁰⁹

In the Netherlands the trustees of a trust might be regarded as a “body of persons”.

Therefore, from a South African, United Kingdom, Canadian and possibly a Dutch perspective, the trustees of a trust could qualify as a “person” for purposes of the OECD MTC.

It is submitted that whether the trust or the trustees are regarded as a “person” under the OECD MTC, is a relevant question. For example, if the trustees are regarded as a “person” and the trustees are resident in more than one country, determining the residence of the

¹⁰⁰⁵ *Commissioner for Inland Revenue v Witwatersrand Association of Racing Clubs* 1960 3 SA 291 (A) 302 and para 5.2.2. The court in *Commissioner for Inland Revenue v Friedman and Others* NNO 1993 1 SA 353 (A) held that a trust is not a body of persons, but did not pronounce whether the trustees would qualify as a body of persons.

¹⁰⁰⁶ In *Kommissaris van Binnelandse Inkomste v Lotz* 1998 (2) SA 282 (O) the trustees of a trust were held to be a person within the meaning of the phrase “'n ander persoon as 'n natuurlike persoon” in the Transfer Duty Act 40 of 1949. The definition of the term person in the Income Tax Act 58 of 1962 s 1 does not refer to “trustee”, but only to “trust”. However, the definition of person uses the word “includes”, which suggests that others, such as trustees, may be included as persons. The definition of the word trustee in s 1 of the Income Tax Act 58 of 1962 also suggests that a trustee is a person.

¹⁰⁰⁷ Avery Jones (1989) 3 BTR 65 fn 91. See also Schwarz *Booth & Schwarz: Residence, Domicile and UK Taxation* 130 who regards the trustees as a “collective legal person” or a “deemed person” in terms of the Income Tax Act 2007 s 474(1). Kessler states that a trustee is “deemed to be a distinct, notional person” (Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 229). Kessler furthermore argues, it is submitted, convincingly, that in the case of a single trustee (whether corporate or individual) the trustee should be regarded as a separate person, distinct from the person acting in their private capacity (Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 230).

¹⁰⁰⁸ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(1).

¹⁰⁰⁹ Avery Jones (1989) 3 BTR 65 fn 93; Waters *Waters' Law of Trusts in Canada* ch 13.11 3; Tremblay and Wharram in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 14:49.

trustees may become problematic. Determining the residence of the trust would clearly solve some of these problems (although determining the residence of a trust is not without its challenges).¹⁰¹⁰ Furthermore, some view the trustees as the person to whom treaty benefits will be given, whereas other countries view the trust as the entity to which the benefits of the treaty will be given. This and other problems regarding the attribution of income will be addressed in a later chapter.¹⁰¹¹

5.6 Characterisation¹⁰¹²

In the introduction to this chapter it was stated that the state applying the treaty (OECD MTC) would have to determine whether the trust with which it is confronted can be regarded as a person. But what laws will that state apply in making such a determination? In this dissertation it is assumed that all states characterise the other state's entity as a trust for both tax and general law purposes.¹⁰¹³

Taken from the viewpoint of the source state (State S), when applying the treaty, it will have to decide whether the trust resident in the other state (State R) is a person. State S must therefore decide whether it may impose its taxes in full or at the reduced treaty rate, or refrain from taxing the specific income. If State S may impose its taxes (either in full or at a reduced rate), State R must provide appropriate relief, either by exempting the income or granting a credit. From State R's perspective, it will apply the treaty in deciding whether or not to grant the appropriate relief for the taxes paid in State S and for this purpose it will decide whether or not the trust is a person entitled to relief.¹⁰¹⁴

Determining which state's laws will apply to assess whether a trust is a person, has significant practical value. An example best illustrates this point. A trust organised and resident in the United Kingdom earns income from a South African source. Both South Africa and the United Kingdom characterise the trust as such for income tax and other purposes. South Africa as the source state has to decide whether the trust is a person for purposes of the OECD MTC. In this chapter the view was taken that in South Africa a trust is a person for purposes of the OECD MTC, whereas under United Kingdom law, a United Kingdom trust will not be regarded as a person. If the United Kingdom trust therefore qualifies as a trust for South African domestic law purposes, it will be regarded as a person if South African law is applied.

Article 23 of the OECD MTC provides that where a resident of state R derives items of income which, in accordance with the provisions of the treaty, may be taxed in State S, State R shall exempt the relevant income or provide an appropriate credit for the taxes paid in State S.¹⁰¹⁵ The OECD commentary provides that the phrase "in accordance with the

¹⁰¹⁰ The residence of a trust is addressed in the following chapter of this dissertation (ch 6).

¹⁰¹¹ See ch 7.

¹⁰¹² The words characterisation, classification and qualification are used as synonyms in this paragraph.

¹⁰¹³ Easson states that when applying tax rules, whether international or domestic, the first step is to classify the entity for tax purposes. A conflict in classification may, however, arise between states due to differences in definition, characterisation and legal attributes. (Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12.2.)

¹⁰¹⁴ Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12.8–12.10.

¹⁰¹⁵ OECD MTC art 23A(1) and 23B(1).

provisions of the treaty” is important where State S and State R classify the same item of income differently for purposes of the OECD MTC.¹⁰¹⁶ The commentary continues as follows:

“Where, due to differences in the domestic law between the State of source and the State of residence, the former applies, with respect to a particular item of income or capital, provisions of the Convention that are different from those that the State of residence would have applied to the same item of income or capital, the income is still being taxed in accordance with the provisions of the Convention, as interpreted and applied by the State of source. In such a case, therefore, the two Articles require that relief from double taxation be granted by the State of residence notwithstanding the conflict of qualification resulting from these differences in domestic law.”¹⁰¹⁷

The article therefore in effect provides that State R is obliged to follow State S’s classification of the income.¹⁰¹⁸ It is important to note that article 23 only applies in the case where State R is obliged to grant relief (an incomplete provision). In other words, where State S must refrain from taxing the relevant income (a complete provision), article 23 is not applied. Therefore the commentary to the article, suggesting that State R is obliged to follow State S’s classification, is not applicable in the case of a complete provision.¹⁰¹⁹

It may be argued that the commentary only applies to conflicts regarding the qualification of *income*.¹⁰²⁰ Other conflicts of qualification are therefore not solved by this particular passage in the commentary. Vogel specifically states that conflicts of qualification regarding the provisions dealing with personal scope, is to be dealt with in terms of article 3(2) and not article 23 and the commentary thereto.¹⁰²¹ Thus, if states do not agree on whether a trust is a “person” for purposes of the treaty, the commentary to article 23 will not apply, but rather article 3(2). Avery Jones, on the other hand, argues that in the case where State S’s domestic law applies via art 3(2) (and the context does not require that domestic law be ignored), that the mutual agreement procedure (article 25 of the OECD MTC) be used to resolve the conflict.¹⁰²² He also suggests that the mutual agreement procedure be used in the case where an autonomous meaning is given to a treaty term, for example when article 3(2) is applied and the context requires that the domestic meaning be disregarded.¹⁰²³

It is submitted that State S, in deciding whether a trust is a person, for purposes of the treaty, will apply its domestic law. State R, in deciding whether or not to grant relief, would, if it is assumed that article 23 can be applied, be obliged to follow state S’s qualification of the income and, by implication, its determination that the trust is a person. Where article 23

¹⁰¹⁶ Commentary on the OECD MTC art 23 para 32.2.

¹⁰¹⁷ Commentary on the OECD MTC art 23 para 32.3.

¹⁰¹⁸ The further Commentary refers to situations in which State R is not obliged to follow State S’s classification of income (Commentary on the OECD MTC art 23 para 32.5–32.7).

¹⁰¹⁹ Vogel (2003) 57 *BFIT* 41 43.

¹⁰²⁰ Avery Jones (2001) 55 *BFIT* 220 220; Vogel (2003) 57 *BFIT* 41 43.

¹⁰²¹ Vogel (2003) 57 *BFIT* 41 43.

¹⁰²² Avery Jones (2001) 55 *BFIT* 220 220; Avery Jones (2003) 57 *BFIT* 184 186. His view is based on the Commentary on the OECD MTC art 23 para 32.5, which states that conflicts resulting from the different interpretation of the facts or different interpretation of the provisions of the convention (as opposed to conflicts of qualification due to the different provisions in domestic law, where State R is obliged to follow State’s qualification) is solved through the mutual agreement procedure.

¹⁰²³ Avery Jones (2001) 55 *BFIT* 220 221.

is not applied, State R would, according to Avery Jones, be obliged to follow the mutual agreement procedure to resolve the matter if it does not agree with State S.

5.7 Conclusion

By analysing the relevant definitions of the OECD MTC, five alternative criteria were identified by which a trust could qualify as a person for purposes of the treaty. These five criteria are that a trust could be regarded as:

- (a) an individual;
- (b) any other body of persons;
- (c) a body corporate;
- (d) any entity that is treated as a body corporate for tax purposes; or
- (e) that a trust may fall within the ordinary meaning of the term person.

This paragraph will discuss whether a trust will qualify as a person in each of the relevant states, based on the criteria set out above as applied in the specific state.

In terms of South African law a trust is neither an individual, nor a juristic person. The term body of persons is not defined in the OECD MTC. If the South African tax law meaning of the term is applied via article 3(2) of the OECD MTC, it has been concluded above that, based on the relevant case law, a trust will not be regarded as a body of persons. Consequently it may be argued that the context requires that the South African domestic law meaning of the term body of persons be disregarded. If the ordinary meaning of the term body of persons is used, it is submitted that a trust will not be regarded as a body of persons. Conceivably an international fiscal meaning of body of persons may be used and possibly a trust will fall within the suggested international fiscal meaning of body of persons. In South Africa, a trust is not subject to the same tax regime as a juristic person and will therefore not be regarded as an entity that is treated as a body corporate for tax purposes in terms of South African tax laws. However, in terms of the ordinary meaning of the term person, a trust will be regarded as a person for purposes of the treaty.

Thus a court will regard a trust governed by South African law as a person for purposes of the treaty. To place the matter beyond any doubt, it may be advisable for South Africa to routinely include a trust specifically in the definition of person in the treaties concluded with other countries, as is done in Canada.

In South Africa the trustees of a trust will be regarded as a person for purposes of the OECD MTC.

In the United Kingdom, a trust is not an individual, nor a juristic person. Applying the United Kingdom meaning of the term body of persons, it is submitted that a trust is not a body of persons, based on the formulation of the Income Tax Act. If one argues that the context requires that the domestic law meaning of the term be disregarded in terms of article 3(2) of the OECD MTC, it is submitted that a trust will not be a body of persons within the ordinary

meaning of that term. If the possibility of using an international fiscal meaning of the term body of persons is considered (where the context requires that the domestic law meaning be ignored), it is submitted that a trust may possibly qualify as a body of persons. Trusts and companies are not subject to the same tax regime and consequently a trust will not be regarded as an entity that is treated as a body corporate for tax purposes in terms of United Kingdom tax laws. A trust will not be regarded as a person in terms of the ordinary meaning of the term person. The trustees of a trust are, however, regarded as a person for purposes of the OECD MTC.

In Canada a trust will be regarded as a person because it is deemed to be an individual for purposes of Canadian income tax. Furthermore, Canada generally provides in its treaties that a trust falls within the definition of the term person. Since a reference to a trust is to be read to include a reference to the trustee, a trustee will be regarded as a person for purposes of the OECD MTC.

In the Netherlands the concept of the APV is regarded as a domestic tax arrangement only and not as a separate entity. It is therefore relevant whether a trust, which, by definition, will be formed by virtue of the laws of another country, will be regarded as a person from the Dutch perspective. A trust is neither regarded as a juristic person, nor as an individual. If the domestic law meaning of the term body of persons is used, a trust will not be regarded as such in the Netherlands. Even if the context requires that the domestic law of the Netherlands be disregarded and the ordinary meaning of the words body of persons be applied, it is submitted that a trust will still not qualify as such. Under the uncertain international fiscal meaning of the term body of persons, a trust may possibly qualify. Some trusts will not be regarded as an entity that is treated as a body corporate for tax purposes in the Netherlands, as trusts and companies are not subject to the same tax regimes while other trusts that are subject to the same tax regime as companies will qualify as such. It is submitted that the trustees of a trust might be regarded as a body of persons.

To summarise, in South Africa and Canada both the trust and the trustees will be a person for purposes of the OECD MTC.¹⁰²⁴ In the United Kingdom, it is submitted that only the trustees would be regarded as a person, since the trust itself will not qualify as a person. In the Netherlands the trust is not a person for purposes of the OECD MTC, but the trustees might be. Thus, in all of the states considered, the trustees will be regarded as a person. In only two of the states will the trust itself be regarded as a person.

¹⁰²⁴ Although both the trust and the trustees could qualify as a “person”, it is submitted that the questions of attribution of income and residence (both of which will be addressed in later chapters) will determine which of the two should be *the* person for purposes of the OECD MTC. See specifically ch 6.2.2.2.

CHAPTER 6

THE RESIDENCE OF A TRUST UNDER THE OECD MTC

Chapter overview	146
6.1 Introduction	148
6.2 The requirements of article 4(1) of the OECD MTC	149
6.2.1 Introduction	149
6.2.2 Liability to tax and fiscal transparency	150
6.2.2.1 General comments	150
6.2.2.2 Trust <i>versus</i> trustee	152
6.2.2.3 Fiscal transparency	157
6.2.2.3.1 General	157
6.2.2.3.2 Degrees of transparency	157
6.2.2.3.3 Partially transparent entities	160
6.2.2.3.4 Conclusion regarding transparency	168
6.2.2.4 Trust income deemed to be that of another	168
6.2.3 By reason of certain factors	171
6.3 Residence under domestic law	175
6.3.1 South Africa	175
6.3.1.1 The definition of “resident”	175
6.3.1.2 Incorporated, established or formed	176
6.3.1.2.1 Introduction	176
6.3.1.2.2 Time and place of establishment or formation	178
6.3.1.3 POEM	182
6.3.1.3.1 The meaning of POEM in the Income Tax Act and DTTs	182
6.3.1.3.2 SARS’s view regarding the meaning of POEM	184
6.3.1.3.3 Case law and academic views regarding the meaning of POEM	187
6.3.1.3.4 Conclusions regarding the meaning of POEM	191
6.3.1.4 Is it possible to change a trust’s residence?	192
6.3.2 United Kingdom	193

6.3.2.1	The Income Tax Act 2007	193
6.3.2.2	Is it possible to change a trust's residence?	196
6.3.3	Canada	197
6.3.3.1	Central management and control	197
6.3.3.2	Income Tax Act	199
6.3.3.3	Is it possible to change a trust's residence?	200
6.3.4	The Netherlands	201
6.4	Dual residence and the tiebreaker provision	202
6.4.1	Introduction: Which tiebreaker should be applied and to whom?	202
6.4.2	Concurrent <i>versus</i> consecutive residence and the meaning of "residence" in terms of article 4(3)	205
6.4.3	The meaning of POEM in the OECD MTC	206
6.4.3.1	The OECD Commentary on article 4(3)	206
6.4.3.2	Cases on the meaning of POEM	207
6.4.3.3	General remarks regarding the meaning of POEM in the OECD MTC	211
6.4.4	Who exercises the effective management of a trust?	213
6.5	Conclusion	219
6.5.1	General	219
6.5.2	Transparency and the "liable to tax" requirement	220
6.5.3	The requirement "by reason of" certain criteria	221
6.5.4	Domestic law	221
6.5.5	The tiebreaker: POEM	222
6.5.6	The residence of a trust: the different states	223
6.5.7	Closing remarks	224

6.1 Introduction

Article 1 of the Organisation for Economic Co-operation and Development Model Tax Convention (OECD MTC) provides that

“[t]his Convention shall apply to persons who are *residents* of one or both of the contracting states” (Own emphasis).

Thus, in addition to being a person, a trust also has to be a resident of one or both of the contracting states in order to benefit from the double taxation treaty (DTT).¹⁰²⁵ It is also important for the functioning of some of the distributive articles of the OECD MTC to determine where the recipient of the income (or in some cases the payer) is resident.¹⁰²⁶ Therefore, if a trust receives (or pays) certain income, its residence will have to be determined in order to apply the distributive rules of the treaty.

Article 4 of the OECD MTC deals with residence. It provides, *inter alia*, that

“[f]or the purposes of this Convention, the term ‘resident of a Contracting State’ means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.”¹⁰²⁷

This provision does not actually define the term residence.¹⁰²⁸ Rather, to determine whether a person is a “resident of a contracting state” the domestic laws of the relevant state is applied and if the person is liable to tax by reason of his or her domicile, residence, place of management or any other criterion of a similar nature, in terms of that domestic legislation, the person is a resident of a contracting state for purposes of the treaty. As the respective domestic rules of the contracting states may cause a person to be a resident in both states, article 4 contains two tiebreaker provisions (one in respect of individuals and one in respect of persons other than individuals) to resolve the conflict. Thus the tiebreaker provision determines where the person will be resident for purposes of the treaty.¹⁰²⁹

¹⁰²⁵ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 4B.01; Schwarz *Schwarz on Tax Treaties* para 14–050; Vogel *et al Klaus Vogel on Double Taxation Conventions* 223; Edwardes-Ker *Tax Treaty Interpretation* para 51.02.

¹⁰²⁶ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 4B.01; Vogel *et al Klaus Vogel on Double Taxation Conventions* 223; Van Raad in *Cursus Belastingrecht* IBR–Hfdst. 3–133.

¹⁰²⁷ OECD MTC art 4(1).

¹⁰²⁸ Vogel *et al Klaus Vogel on Double Taxation Conventions* 233. The Commentary states, however, that the expression “resident of a contracting state” is defined (Commentary on the OECD MTC art 4 para 8).

¹⁰²⁹ In terms of art 4 of the OECD MTC residence is determined for purposes of the treaty. Usually this will mean that the person’s residence in terms of domestic legislation is unaffected. However, in some countries (eg South Africa) a person ceases to be a resident for domestic law purposes if that person is deemed not to be a resident for treaty purposes (Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 4B.02; Vogel *et al Klaus Vogel on Double Taxation Conventions* 225; Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 212).

There are two situations in which an entity's eligibility for treaty benefits will have to be determined:¹⁰³⁰

- (a) Where a non-resident of a treaty country claims a reduction of source country taxation. In relation to trusts, this will occur, for example, if a South African resident trust acquires income from a source in another country and the trust wants to claim a reduction of taxes in that other country in terms of the DTT. Another example would be where a trust that is not resident in South Africa (say, a resident of Canada) receives income from a South African source and wants to claim a reduction of South African withholding tax in terms of the South Africa-Canada DTT; and
- (b) Where a taxpayer, in terms of a DTT between its residence country and the source country, claims relief in its residence country from double taxation for taxes paid in the country in which the income was sourced. For example, a South African resident trust may claim relief from double taxation in South Africa in respect of taxes paid in the source country.

According to Easson, in the first situation ((a) above) it is the law of the country where the treaty claimant asserts residence that must be used to determine its residence.¹⁰³¹ In the second situation ((b) above) residence is determined in terms of the treaty and depends on liability to tax in the country of residence.¹⁰³²

This chapter will discuss the application of the provisions of article 4 of the OECD MTC to trusts. As a starting point, the requirements of article 4(1) will be discussed. The liable to tax requirement and the requirement that liability must be by reason of certain factors, will be focused on. Since article 4(1) requires that reference be made to domestic law, a discussion of the domestic law determining the residence of trusts in each of the relevant states will follow. The tiebreaker provision of article 4(3) of the OECD MTC and its application in relation to trusts will also be discussed.

6.2 The requirements of article 4(1) of the OECD MTC

6.2.1 Introduction

Couzin lists four requirements that a company must meet, in order to be a resident in terms of article 4(1):¹⁰³³

¹⁰³⁰ Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12.7.

¹⁰³¹ Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12.9.

¹⁰³² Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12.10. Some support for Easson's view may be gleaned from Lang, who states that whether a person qualifies under art 4(1) and is thus liable to tax, is to be considered under the laws of the state of residence and not under the laws of the state of source or the state of application (as mentioned in art 3(2)) (Lang (2001) 55 *BFIT* 596 598).

¹⁰³³ Couzin *Corporate Residence and International Taxation* 105. Kessler lists four other requirements: (a) there must be a person; (b) the person must be liable to tax in the state; (c) the person must be domestic law resident in that state; (d) domestic law residence must be the reason for liability to tax (Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 213). Requirement (a) in Kessler's list is addressed in ch 5. Requirement (b) in Kessler's list corresponds with requirement (a) in Couzin's list. The reference to "domestic law residence" in requirements (c) and (d) in Kessler's list should be read as "UK law resident". If it is borne in mind that a person is liable to tax in the UK by reason of residence (Kessler *Taxation of Non-Residents and*

- (a) the company must be liable to tax in the relevant state;
- (b) such liability must be “by reason of” a connecting factor;
- (c) the connecting factor must fall within the listed criteria; and
- (d) the liability to taxation must arise under the laws of one of the contracting states.

It is submitted that these requirements apply equally to trusts and will, accordingly, be discussed in relation to trusts in this paragraph.¹⁰³⁴

6.2.2 Liability to tax and fiscal transparency

6.2.2.1 General comments

In order to qualify as a resident of a contracting state, a person has to be liable to tax in that state by reason of certain criteria. The term liable to tax is not defined in the OECD MTC.¹⁰³⁵ The Commentary suggests that liable to tax connotes “comprehensive taxation” or “full liability to tax”.¹⁰³⁶ Such comprehensive or full liability to tax arises only when a state taxes a person’s worldwide income (under the criteria mentioned) and does not arise when such a state taxes a person’s income only from sources arising in that state.¹⁰³⁷

However, a person does not in fact have to pay tax in order to be liable to tax.¹⁰³⁸ Thus, the Commentary notes that most countries will view bodies that are exempted from tax if they meet certain criteria, such as charities, as liable to tax.¹⁰³⁹ Indeed, Couzin regards the term liable to tax to mean “liable to be liable to tax”.¹⁰⁴⁰ However, there is a continuum of non-taxability, ranging from the use of losses to eliminate taxes on the one end to the complete exclusion of a person from the income tax system on the other and it is unclear where the line must be drawn. The effect of the OECD MTC seems to be that, if domestic legislation

Foreign Domiciliaries 211 and 213), it is submitted that requirements (c) and (d) in Kessler’s list are in effect the same as requirements (b) to (d) of Couzin’s list.

¹⁰³⁴ Although all four requirements are addressed in this paragraph, the requirements are combined under two headings, for the sake of convenience.

¹⁰³⁵ Strictly speaking “liable to tax” is not a term, but a phrase. However, the word “term” was used in ch 5 in relation to other words in the OECD MTC and, for the sake of consistency and convenience, this is continued in relation to “liable to tax”.

¹⁰³⁶ Commentary on the OECD MTC art 4 para 8.3.

¹⁰³⁷ De Graaf and Pötgens (2011) 39 *Intertax* 169 169. The Commentary states that the intention of the second sentence of article 4 is not to exclude from the scope of the DTT all residents from states that employ the territorial principle in their taxation (Commentary on the OECD MTC art 4(1) para 8.3). According to Wheeler this explanation by the OECD is not entirely satisfactory (Wheeler (2011) 3 *World Tax Journal* 247 252).

¹⁰³⁸ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 4B.05; Harris and Oliver *International Commercial Tax* 63; Vogel *et al Klaus Vogel on Double Taxation Conventions* 229; Couzin *Corporate Residence and International Taxation* 108. Many authors distinguish between the terms “liable to tax” and “subject to tax”, the former having a wider meaning than the latter, connoting an abstract liability to tax, which will be met even if a person does not actually pay any tax due to, eg, a loss or an exemption. The term “subject to tax”, on the other hand, connotes an effective or actual liability to pay tax (eg see De Graaf and Pötgens (2011) 39 *Intertax* 169 172; Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 4B.05; Wheeler (2011) 3 *World Tax Journal* 247 287).

¹⁰³⁹ Commentary on art 4 of the OECD MTC para 8.6.

¹⁰⁴⁰ Couzin *Corporate Residence and International Taxation* 107.

first imposes a liability to tax and then reduces it, the person will be liable to tax. If, however, no tax is imposed from the start, a person will not be regarded as liable to tax. This effect has been criticised.¹⁰⁴¹

In South Africa, no case law exists and the revenue authority has issued no guidance regarding the question whether exempt entities are liable to tax. However, the view has been expressed that in South Africa public benefit organisations that enjoy exemption from tax, will be regarded as liable to tax.¹⁰⁴² In the United Kingdom, charities are regarded as liable to tax and therefore resident for treaty purposes. This view is supported by Her Majesty's Revenue and Customs (HMRC).¹⁰⁴³ It has been argued that in Canada, case law suggests that tax-exempt entities are not liable to tax and therefore not residents.¹⁰⁴⁴ The Canadian revenue authority disagrees with this interpretation and it is generally accepted that tax-exempt entities are liable to tax.¹⁰⁴⁵ In the Netherlands, the *Hoge Raad* has held that, with regard to a DTT that expressly referred to certain exempt entities as treaty residents, other exempt entities that were not mentioned will not be regarded as liable to tax.¹⁰⁴⁶ However, from this judgement one cannot deduce how the court will interpret a provision similar to article 4(1) of the OECD MTC. The Dutch Ministry of Finance therefore prefers to include criteria regarding liability to tax to ensure certainty regarding all exempt entities. It is their policy that tax-exempt institutions, such as pension funds and other non-profit organisations, be regarded as liable to tax.¹⁰⁴⁷

It should further be noted that the OECD MTC does not require a resident of a state to be liable to tax on a specific item of income in order to claim treaty benefits regarding that income. Provided that there is a general liability for tax and the person derives or receives income, the treaty will be applied, irrespective of whether the person is liable to tax on the specific item of income.¹⁰⁴⁸ This point is well illustrated by the *Smallwood* case¹⁰⁴⁹ in the United Kingdom. The case concerned the liability to capital gains tax in the United Kingdom

¹⁰⁴¹ Wheeler (2011) 3 *World Tax Journal* 247 252. See also Couzin *Corporate Residence and International Taxation* 115. There are further points of uncertainty regarding the interpretation of the term liable to tax. The term tax is not defined, but a sensible interpretation would be to limit the liability to income tax and not any other tax (Wheeler (2011) 3 *World Tax Journal* 247 253). Furthermore, both the literature and case law suggest that there is uncertainty on whether potential liability to tax is enough for a person to be regarded as liable to tax for purposes of the DTT. This issue arises when a person has significant connections with a state, but that state does not in fact impose any tax (Wheeler (2011) 3 *World Tax Journal* 247 253; Galea (2012) 66 *BFIT* para 3.1). This latter point will be reverted to when Lang's view is discussed in ch 6.2.2.3.3.

¹⁰⁴² Hattingh in *Residence of Companies under Tax Treaties and EC Tax Law* 715.

¹⁰⁴³ Kessler and Brown *Taxation of Charities and Non-Profit Organisations* 415.

¹⁰⁴⁴ Ward *et al* (1996) 44 *Canadian Tax Journal* 408 419.

¹⁰⁴⁵ Brooks in *Residence of Companies under Tax Treaties and EC Law* 430; Berry (2007) 46 *Tax Notes International* 933 934.

¹⁰⁴⁶ 2009 HR 08/05071.

¹⁰⁴⁷ Ministerie van Financiën *Notitie Fiscaal Verdragsbeleid* para 2.2.1. Certain commentators take a different view of the *Hoge Raad's* decision. They interpret it to mean that a person must actually be liable for tax in order to be regarded as a resident. These commentators provide reasons why they do not agree with the *Hoge Raad's* decision and also propose amended wording for the OECD MTC to ensure greater clarity regarding the meaning of the term liable to tax (De Graaf and Pötgens (2011) 39 *Intertax* 169).

¹⁰⁴⁸ Wheeler (2011) 3 *World Tax Journal* 247 273. Wheeler refers to the absence of the link between a resident's liability for tax and a specific item of income for which treaty protection is claimed as the "missing keystone" in DTTs (Wheeler (2011) 3 *World Tax Journal* 247 280). See also Couzin *Corporate Residence and International Taxation* 110.

¹⁰⁴⁹ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778.

of the trustees (or the settlor) of the Smallwood Settlement. The trustees argued that they were not liable to the relevant tax, based on the provisions of the DTT between the United Kingdom and Mauritius, which, according to the trustees, granted the sole right to tax capital gains to Mauritius. Mauritius does not, in fact, tax capital gains. If the trustees' argument were to succeed (which it did not), the effect would be that no tax would be payable in either the United Kingdom or Mauritius. The Court of Appeal accepted that the fact that Mauritius does not tax capital gains, is irrelevant for the application of article 4, in the sense that liable to tax refers to any of the taxes covered by the relevant DTT.¹⁰⁵⁰ Therefore, the fact that capital gains tax, which was the tax in issue in this case, was not charged in Mauritius, was irrelevant, based on the fact that the trustees were in general liable to tax in Mauritius. The court further confirmed that the term liable to tax means "chargeable to tax", in the sense that although a person may be physically resident for only part of a year, if that physical residence leads to chargeability for the whole year under the domestic laws of the residence country, the person will be a resident that is liable to tax for purposes of the treaty.¹⁰⁵¹

6.2.2.2 Trust *versus* trustee

In a previous chapter it was concluded that in South Africa and Canada both the trust and the trustee could be regarded as a "person" for purposes of the OECD MTC. In the United Kingdom only the trustees can be regarded as a "person" and in the Netherlands the trustees might be regarded as a person. It was submitted that the issue of residence would, *inter alia*, determine who the relevant person would be that could claim relief in terms of a DTT.¹⁰⁵²

The point is also illustrated by the case law. In the South African case of *Oceanic Trust*¹⁰⁵³ the court pronounced on whether the relevant trust was a resident. In the Canadian *Fundy Settlement* case, the court had to decide where the trust was resident for Canadian domestic law purposes. The court was emphatic that the relevant taxpayer was the trust and not the trustees and that it was the trust's residence that had to be determined.¹⁰⁵⁴ In the United Kingdom case of *Smallwood*, the court was concerned with the residence of the trustees for treaty purposes.¹⁰⁵⁵ However, the court in *Smallwood* seemed to equate the residence of the trust with the trustees:

"The POEM with which this case is concerned is, as it seems to me, the POEM of the trust, i.e. of the trustees as a continuing body."¹⁰⁵⁶

It has led Cleave to observe that the difference between the residence of the trust (as in *Fundy Settlement*) and the trustees (as in *Smallwood*) may be more apparent than real.¹⁰⁵⁷ This sentiment is echoed by Kessler who doubts that the question whether the person for

¹⁰⁵⁰ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 para 12.

¹⁰⁵¹ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 paras 40–42.

¹⁰⁵² See ch 5.7.

¹⁰⁵³ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127.

¹⁰⁵⁴ *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520 para 13.

¹⁰⁵⁵ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 para 69.

¹⁰⁵⁶ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 para 69. The court used the acronym POEM, which, off course, refers to "place of effective management".

¹⁰⁵⁷ Cleave (2011) 6 BTR 705 713.

the purposes of the OECD MTC is the trustees (as a body) or the trust, makes a difference in practice.¹⁰⁵⁸

It is suggested that the domestic law of the relevant states should be examined to determine whether the trust's or the trustees' residence should be determined. As stated above, it is the tax laws of the state where the treaty claimant is resident that should determine whether that person is resident.¹⁰⁵⁹

In South Africa, a trust is included in the definition of person.¹⁰⁶⁰ The terms trust, trustee and beneficiary are all defined for purposes of the Income Tax Act.¹⁰⁶¹ The term taxpayer is defined to mean "any person chargeable with any tax leviable under this Act".¹⁰⁶² The main charging provision provides that income tax is to be paid annually in respect of the taxable income received by or accrued to or in favour of any person (other than a company) during the year of assessment ending the last day of February each year.¹⁰⁶³ The provision that specifically deals with trusts provides that

"[a]ny amount received by or accrued to or in favour of any person during any year of assessment in his or her capacity as the trustee of a trust, shall, subject to the provisions of section 7, to the extent to which that amount has been derived for the immediate or future benefit of any ascertained beneficiary who has a vested right to that amount during that year, be deemed to be an amount which has accrued to that beneficiary, and to the extent to which that amount is not so derived, be deemed to be an amount which has accrued to that trust."¹⁰⁶⁴

From this provision it can be deduced that an amount to which no ascertained beneficiary has a vested right during the year, is deemed to be an amount which has accrued to the relevant trust. Therefore, although the trustee receives an amount (or it accrues to the trustee), it is deemed under the relevant circumstances to accrue to the trust. Returning to the main charging provision, it is, accordingly, the trust (which is a person, by definition) to whom the income accrues and which is therefore liable to tax. The trust will therefore qualify as a taxpayer, since it is chargeable with tax.

The trustees of the trust are, however, regarded as the representative taxpayers of the trust.¹⁰⁶⁵ The Tax Administration Act defines a taxpayer, *inter alia*, as a person chargeable to tax or a representative taxpayer.¹⁰⁶⁶ That Act further provides that a person chargeable to tax is a person upon whom the liability for tax due under a tax act is imposed and who is

¹⁰⁵⁸ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 230.

¹⁰⁵⁹ See ch 6.1.

¹⁰⁶⁰ Income Tax Act 58 of 1962 s 1 definition of "person".

¹⁰⁶¹ Income Tax Act 58 of 1962 s 1.

¹⁰⁶² Income Tax Act 58 of 1962 s 1 definition of "taxpayer".

¹⁰⁶³ Income Tax Act 58 of 1962 s 5(1)(c). The term "taxable income" is also defined in s 1.

¹⁰⁶⁴ Income Tax Act 58 of 1962 s 25B(1).

¹⁰⁶⁵ Income Tax Act 58 of 1962 s 1 para (c) of the definition of "representative taxpayer", read with the Tax Administration Act 28 of 2011 s 1 definition of "representative taxpayer".

¹⁰⁶⁶ Tax Administration Act 28 of 2011 s 151.

personally liable for the tax.¹⁰⁶⁷ The Tax Administration Act sets out the liability of a representative taxpayer, namely

“[a] representative taxpayer is, as regards –

- (a) the income to which the representative taxpayer is entitled;
- (b) moneys to which the representative taxpayer is entitled or has the management or control;
- (c) transactions concluded by the representative taxpayer; and
- (d) anything else done by the representative taxpayer,

in such capacity –

- (i) subject to the duties, responsibilities and liabilities of the taxpayer represented;
- (ii) entitled to any abatement, deduction, exemption, right to setoff a loss, and other items that could be claimed by the person represented; and
- (iii) liable for the amount of tax specified by a tax Act.”¹⁰⁶⁸

A representative taxpayer may be assessed in respect of any tax, but such assessment is regarded as made upon the representative taxpayer in such capacity only. The Tax Administration Act also provides for personal liability of the representative taxpayer and reads as follows

“A representative taxpayer is personally liable for tax payable in the representative taxpayer’s representative capacity, if, while it remains unpaid –

- (a) the representative taxpayer alienates, charges or disposes of amounts in respect of which the tax is chargeable; or
- (b) the representative taxpayer disposes of or parts with funds or moneys, which are in the representative taxpayer’s possession or come to the representative taxpayer after the tax is payable, if the tax could legally have been paid from or out of the funds or moneys.”¹⁰⁶⁹

Bearing in mind that the trustee of a trust manages and controls the trust funds, it is clear that the trustee, as representative taxpayer, is liable for the amount of tax specified in the Income Tax Act. Regarding the personal liability of the trustee as representative taxpayer, it should be noted that personal liability only kicks in when tax remains unpaid. Therefore, as long as the trustee keeps tax payments up to date, there will be no personal liability. If, however, taxes are unpaid, personal liability only arises when certain actions are taken by the trustee (for example, alienation or disposal of certain amounts). If these actions are not

¹⁰⁶⁷ Tax Administration Act 28 of 2011 s 152.

¹⁰⁶⁸ Tax Administration Act 28 of 2011 s 154.

¹⁰⁶⁹ Tax Administration Act 28 of 2011 s 155.

taken while taxes are unpaid (that is, if the trustees “do nothing”, including failing to pay the tax due), there is no personal liability for the trustee in terms of the Tax Administration Act. It is therefore submitted that the trustee, as representative taxpayer, is not chargeable to tax, since only one of the two conditions for chargeability is met: although the trustee is liable for the tax due, he or she is not, generally speaking, personally liable for the tax.¹⁰⁷⁰ If this argument is incorrect and the trustee can be charged with tax in his or her representative capacity in terms of the Tax Administration Act, it should be borne in mind that in the case of an inconsistency between the Tax Administration Act and the Income Tax Act, the latter prevails.¹⁰⁷¹

It is therefore submitted that in terms of South African law the person chargeable to income tax is the trust and not the trustee. In terms of South African domestic tax law, the trust is therefore the only person who could be liable to tax and, accordingly, a resident for purposes of article 4(1) of the OECD.

In the United Kingdom the trustee of a trust, and not the trust itself, is liable to tax.¹⁰⁷² HMRC states that

“[t]rusts are not themselves liable to tax in the UK, but the trustees on behalf of the trust may be liable to tax in the UK. A trust therefore cannot be a resident of the UK for the purposes of any UK Double Taxation Convention (DTC).”¹⁰⁷³

In respect of the United Kingdom where it is the trustee, and not the trust, whose residence must be determined, a further matter must be addressed. A trustee acts in his or her personal capacity and in his or her capacity as trustee. A trustee also has two separate estates.¹⁰⁷⁴ A trustee is liable to pay tax in these separate capacities as well. In the United Kingdom, the trustees are regarded as a distinct, notional person for income tax purposes, separate from the persons who are trustees.¹⁰⁷⁵ Thus, for tax purposes “... the person acting as trustee is generally regarded as a separate person from the same person acting in its private capacity”.¹⁰⁷⁶ However, the OECD MTC does not distinguish between the different capacities of the relevant person.¹⁰⁷⁷ Prebble therefore argues that if a person is a resident in his or her personal capacity, but also happens to be a trustee of a trust, that trustee is also resident in his or her capacity as trustee.¹⁰⁷⁸ Prebble contends that the wording of clauses similar to article 4(1) of the OECD MTC does not support a distinction between the different capacities.¹⁰⁷⁹

¹⁰⁷⁰ It would be absurd to argue that the trustee could potentially qualify as a resident for treaty purposes (because the trustee is regarded as liable to tax) only in circumstance where taxes are in arrears and the trustee has taken certain actions to alienate or dispose of amounts that could have been used to pay the taxes.

¹⁰⁷¹ Tax Administration Act 28 of 2011 s 4(3).

¹⁰⁷² Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 230.

¹⁰⁷³ Her Majesty's Revenue and Customs *International Manual* para 162034.

¹⁰⁷⁴ See ch 2.3.3.

¹⁰⁷⁵ Income Tax Act 2007 s 474.

¹⁰⁷⁶ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 229.

¹⁰⁷⁷ Wheeler (2011) 3 *World Tax Journal* 247 250; Wheeler in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 49.

¹⁰⁷⁸ Wheeler seems to support this point (Wheeler in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 49).

¹⁰⁷⁹ Prebble (2004) 2 *eJournal of Tax Research* 6.

Kessler, on the other hand, argues that the trustees (whether there is one or more than one) are regarded as a body of persons and therefore constitute a “person” for treaty purposes. He asserts that that person (which he calls the “trustee-person”) is “necessarily distinct from the persons who act as trustees.”¹⁰⁸⁰ He argues that it is possible for a person to be treaty-resident in one state in his or her private capacity and treaty-resident in another state in his or her trustee capacity.¹⁰⁸¹ Kessler’s view is preferred as article 4(1) specifically requires the application of domestic law and in terms of United Kingdom domestic law the trustees are regarded as a person distinct from the persons acting as such in their personal capacities.

In Canada it is the trust and not the trustee that is liable to tax. The Supreme Court of Canada recently stated as follows:

“... s. 2(1) is the basic charging provision of the Act, and its reference to a ‘person’ must be read as a reference to the taxpayer whose taxable income is being subjected to income tax. This is the trust, *not* the trustee.”¹⁰⁸²

Commenting on this case, Avery Jones and Nikolakakis make the following interesting point:

“In contrast UK tax law refers to the trustee and never to a trust. As soon as one talks about a trust being the taxable person, even though one knows that it is not legally a person, one is drawn to thinking of it as an entity (and it is the same with partnerships). Looking for the trust’s central management and control seems to be a natural consequence of thinking in this way, whereas in the UK the legislation talks about the trustee and so the question is one of the residence of the trustee, which fortunately the statute deals with, but if it had not it is very doubtful that the courts would have come up with central management and control. The different way of viewing the question affects the answer, although even if the taxable person is the trustee as such it would be necessary to rely on some form of abstraction where there are multiple trustees and they do not all reside in the same place.”¹⁰⁸³

To conclude, in South Africa and Canada, the relevant person who is liable to tax in terms of domestic law is the trust itself. It is therefore the trust that is the “person” for purposes of article 1 and it is the trust whose residence should be determined in terms of domestic law for purposes of article 4(1). In the United Kingdom, it is the trustees, as a body, that is liable to tax in terms of domestic law. It is therefore the trustees (as a body) who are a person for purposes of article 1 and whose residence should be determined for purposes of article 4(1).

The question therefore arises how the treaty should be applied if one state taxes the trust and the other state taxes the trustees.¹⁰⁸⁴ For example, if trustees that are resident in the United Kingdom receive income from a South African source, they will try to obtain a reduced withholding tax rate in terms of the treaty between South Africa and the United Kingdom. South Africa would have levied the withholding tax against the trust. Similarly, a South African resident trust may receive income from a source in the United Kingdom.

¹⁰⁸⁰ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 230.

¹⁰⁸¹ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 229.

¹⁰⁸² *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520.

¹⁰⁸³ Avery Jones and Nikolakakis (2012) 14 *International Tax Law Reports* 1090 1092.

¹⁰⁸⁴ Wheeler in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 50.

The other example would be where trustees resident in the United Kingdom claim relief in the United Kingdom from double taxation for taxes paid in South Africa where the income was sourced. Similarly, a South African resident trust may claim relief in South Africa for taxes paid in the United Kingdom on income sourced in that country.

It is submitted that this point is a problem of attribution, a matter that will be addressed in a later chapter.¹⁰⁸⁵

6.2.2.3 Fiscal transparency

6.2.2.3.1 General

It is generally accepted that if a state treats an entity as fiscally transparent, it is not liable to tax and therefore cannot be regarded as a resident of a contracting state.¹⁰⁸⁶ By fiscal transparency is meant that the income is not taxed in the hands of the relevant entity, but rather in the hands of the members or associates.¹⁰⁸⁷ Thus, in the case of a trust, it will be regarded as transparent if income is taxed in the hands of the beneficiaries, rather than in the trust itself.

Couzin identifies two reasons why transparent partnerships should not be regarded as liable to tax and it is submitted that these reasons could be applied to trusts as well. Firstly, it is inappropriate to describe a partnership that is not a tax subject as a resident of that state. Residence, as used in article 4(1) in relation to the list of criteria, connotes a connecting factor that is susceptible to give rise to tax liability. It is improbable that a state that treats a partnership as transparent, can apply its domestic concept of residence to that partnership in a sensible way. Secondly, the likelihood of a transparent partnership becoming taxable is very remote, since it would require a change in the nature of the tax system. It is therefore unreasonable to assume that the contracting states intended the term liable to tax to include such a remote possibility.¹⁰⁸⁸

6.2.2.3.2 Degrees of transparency

Different degrees of transparency may be noted:¹⁰⁸⁹

¹⁰⁸⁵ See ch 7 in general and more specifically examples 7.3.1.3 and 7.3.2.3.

¹⁰⁸⁶ Vogel (2001) 55 *BFIT* 91 91; Harris and Oliver *International Commercial Tax* 63; Edwardes-Ker *Tax Treaty Interpretation* 51.03; OECD *The Application of The OECD Model Tax Convention to Partnerships* para 34. The contrary view of Lang is discussed below. The aforementioned report by the OECD regarding partnerships focuses on partnerships, but acknowledges that many of the principles contained in the report may apply with respect to other non-corporate entities (OECD *The Application of The OECD Model Tax Convention to Partnerships* para 1). The report has been used in academic literature to examine the position of trusts (eg Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* and Danon (2004) 32 *Intertax* 210).

¹⁰⁸⁷ Larking *IBFD International Tax Glossary* 423; OECD *The Application of The OECD Model Tax Convention to Partnerships* para 19.

¹⁰⁸⁸ Couzin *Corporate Residence and International Taxation* 117.

¹⁰⁸⁹ The terminology used by Baker (Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* 1B.30) is followed in this paragraph. See also Larking *IBFD International Tax Glossary* 423; OECD *The Application of The OECD Model Tax Convention to Partnerships* para 21; Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12.11.

- (a) Complete transparency: the entity is completely ignored for tax purposes.
- (b) Transparency with reporting requirements: the entity is not taxed, but it has certain reporting duties towards the taxing authorities. These entities are sometimes referred to as “translucent” or “translucid”.
- (c) Optional transparency: the entity or its participators may elect whether it will be regarded as transparent or not.
- (d) Partial transparency: the entity is taxed on part of its income and its members or associates on the other part.¹⁰⁹⁰

In practice, the degree of transparency of an entity, especially trusts, may change from year to year. Thus, trusts (more specifically, discretionary trusts) may be fully transparent in one year, opaque in the next and partially transparent in a further year. This may happen because the trustee may decide to distribute all of the trust’s income to a beneficiary in a given year, which will cause the trust to be fully transparent. In the next year, the trustee may decide not to distribute any income, making the trust completely opaque in that year. In a further year, the trustee may decide to distribute a portion of the income to the beneficiaries and retain the rest, making the trust partially transparent.

The question that arises is therefore what level of transparency is required for an entity to be regarded as either transparent or opaque. If an entity is classified as “opaque”, it may be regarded as a resident (because it is liable to tax), whereas classification as “transparent” will lead to the conclusion that the entity is not liable to tax and therefore is not a resident.¹⁰⁹¹

According to the OECD, to determine whether a partnership is liable to tax

“the real question is whether the amount of tax payable on the partnership income is determined in relation to the personal characteristics of the partners (whether the partners are taxable or not, what other income they have, what are the personal allowances to which they are entitled and what is the tax rate applicable to them). If the answer to that question is yes, then the partnership should not itself be considered to be liable to tax. The fact that the income is computed at the level of the partnership before being allocated to the partners, that the tax is technically paid by the partnership or that it is assessed on the partnership as described in the preceding paragraph will not change that result.”¹⁰⁹²

A factor that may indicate that the partnership itself is not liable to tax, but rather the partners, is that income retains its nature when it is allocated to a partner, who then adds

¹⁰⁹⁰ Easson notes a second example of partial transparency, namely where the entity pays tax, not for its own account, but for the account of its participants. Participants are allowed a credit for their share in the tax on their personal income tax liability (Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12.12).

¹⁰⁹¹ Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12:13.

¹⁰⁹² OECD *The Application of The OECD Model Tax Convention to Partnerships* para 40.

his or her share of the partnership income to his or her income to determine his or her taxable income.¹⁰⁹³

From the Partnership Report it may therefore be deduced that entities that fall within items (a) (completely transparent) and (b) (transparent with reporting requirements) above will not be regarded as residents in the relevant state.¹⁰⁹⁴ An illustration of the treatment of a partnership falling within item (b) may be found in the South African case of *Grundlingh*.¹⁰⁹⁵ The case involved a South African resident individual, who was a partner in a partnership of attorneys which was formed and practised in Lesotho. It was common cause that a partnership is not a juristic person in either South Africa or Lesotho. Nor was it treated as a separate taxable entity in either of the two states. Both states therefore regarded the partnership as transparent and taxed the partner on his or her share of the partnership income. In terms of the relevant Lesotho tax legislation, the partnership was, however, required to file a partnership return of income, but the legislation was explicit that the partners and not the partnership were taxable. The court held that the Lesotho partnership was not “an enterprise liable to pay tax in Lesotho”, as was required by article 7 of the DTT between South Africa and Lesotho (which was based on article 7 of the OECD MTC). The court’s finding demonstrates the point that the practical, administrative rules which treated the partnership as a “separate” entity, such as the filing of a partnership return, is irrelevant in determining whether the partnership is liable to tax. What is relevant is the legal position of the partnership as a transparent entity, which was set out by the relevant statute.¹⁰⁹⁶

Applying the Partnership Report to trusts, it could be argued, in respect of trusts falling within items (a) (completely transparent) and (b) (transparent with reporting requirements) above, that these trusts are not liable to tax. Therefore, if a trust is completely ignored for tax purposes and is consequently completely transparent, with or without reporting requirements, it will not be regarded as liable to tax and, hence, not be a resident of the relevant state. An example of a trust that is completely ignored for tax purposes is a bare trust in the United Kingdom,¹⁰⁹⁷ where the beneficiary is, generally speaking, chargeable to tax.¹⁰⁹⁸ Similarly, a bare trust is excluded from the definition of a trust in terms of Canadian legislation and is therefore ignored for tax purposes.¹⁰⁹⁹ In South Africa, an example of a completely transparent trust for income tax purposes would be a vesting trust, where all the income accrues to ascertained beneficiaries with vested rights.¹¹⁰⁰

¹⁰⁹³ OECD *The Application of The OECD Model Tax Convention to Partnerships* para 38.

¹⁰⁹⁴ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* 1B.30; OECD *The Application of The OECD Model Tax Convention to Partnerships* paras 34–40.

¹⁰⁹⁵ *Grundlingh v Commissioner for the South African Revenue Service* 2009 72 SATC 1.

¹⁰⁹⁶ Hattingh (2010) 127 SALJ 38 45.

¹⁰⁹⁷ A bare trust is one in which a beneficiary has an immediate and absolute title to the income and capital of the trust. The beneficiary is entitled to the equitable interest in the trust without any contingencies attached (Chamberlain and Whitehouse *Trust Taxation* para 42.01). See also ch 2.3.4.2 in respect of Scotland.

¹⁰⁹⁸ Chamberlain and Whitehouse *Trust Taxation* para 42.06; Gordon *et al* *Tiley and Collison's UK Tax Guide 2013–14* para 21.3.

¹⁰⁹⁹ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(1); Brown in *Topical Analysis* para 1.4.1.

¹¹⁰⁰ Income Tax Act 58 of 1962 s 25B(1). See ch 2.2.4 regarding vesting trusts in South Africa. See also Honiball and Olivier *The Taxation of Trusts in South Africa* 287, who supports the view that vesting trusts will not be liable to tax.

Academic authors suggest that entities falling within item (c) (optional transparency) above should be regarded as residents if they elect to be treated as non-transparent.¹¹⁰¹ Others suggest that if these entities elect to be treated as transparent, it is the partners, rather than the partnership, that is liable to tax, so that the partnership is not entitled to the benefits of the treaty.¹¹⁰² Yet in the Canadian case of *TD Securities*,¹¹⁰³ the court, in a controversial decision,¹¹⁰⁴ held that a United States Limited Liability Company (LLC) was liable to tax and therefore a resident of the United States for purposes of the treaty between the United States and Canada. In terms of United States legislation, the LLC was treated as transparent (having failed to exercise an election to be treated as opaque), its income being taxed in the hands of its only shareholder, a United States resident corporation. The court held that the LLC itself, and not its shareholder, was regarded as liable to tax and therefore a resident of the United States.¹¹⁰⁵

6.2.2.3.3 Partially transparent entities

The Partnership Report specifically states that it does not deal with the residence of entities falling under item (d) (partially transparent entities) above.¹¹⁰⁶ The report acknowledges that trusts, specifically, are often treated by domestic tax laws as partially transparent.¹¹⁰⁷ Partial transparency in the case of a trust could entail, for example, that the beneficiaries of a trust are taxed on the income distributed to them, while the trust (or the trustee) is taxed on the undistributed trust income. A further example would be where the trust is taxed on the full amount of the trust income, but the beneficiaries are allowed a credit for the tax paid, to set off against their own personal liability for tax.¹¹⁰⁸ Easson applies the test laid down in the Partnership Report and quoted above to partially transparent entities other than partnerships and concludes that partially transparent trusts that are taxed on their undistributed income, will not be transparent and will consequently be regarded as liable to tax. He argues that, even if a trust distributes all of its income and therefore pays no tax, it will still be regarded as liable to tax. Similarly, in the case of a trust that is taxed on the full

¹¹⁰¹ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* 1B.30; Couzin *Corporate Residence and International Taxation* 121.

¹¹⁰² Harris and Oliver *International Commercial Tax* 63.

¹¹⁰³ *TD Securities (USA) LLC v Her Majesty the Queen* 2010 TCC 186.

¹¹⁰⁴ For criticism against the case see Wheeler (2011) 3 *World Tax Journal* 247 337 and the references cited there.

¹¹⁰⁵ See also *Linklaters LLP v Income tax Officer - International Taxation Ward 1(1)(2), Mumbai* ITA No 4896/Mum/03 and 5085/Mum/03, an Indian case in which a similar conclusion was reached and the German decision of the *Bundesfinanzhof* BFH decision of 20 August 2008 I R 39/07. In the states under scrutiny, trusts, generally, do not have such an election. An exception to this statement is that in Canada a trustee can designate dividends received from a Canadian resident corporation to retain its nature in the hands of the beneficiary. (A trustees can also designate that foreign source income retain its nature if it is taxed in the hands of the beneficiaries, but this arrangement only applies for purposes of granting a tax credit to the beneficiary and is not a general rule.) As stated earlier, the fact that income retains its nature may indicate that the beneficiaries, rather than the trust, are liable to tax. In Canada, trustees may effectively elect whether or not certain dividend income retains its nature in the hands of the beneficiary. Whether this election will put the trust within the category of optional transparency and what the effect of such categorisation will be, falls outside the scope of this dissertation. The focus of this dissertation falls on South Africa.

¹¹⁰⁶ OECD *The Application of The OECD Model Tax Convention to Partnerships* para 37.

¹¹⁰⁷ OECD *The Application of The OECD Model Tax Convention to Partnerships* para 37.

¹¹⁰⁸ Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12:12.

amount of the income, with a credit granted to the beneficiary, the trust will be regarded as liable to tax.¹¹⁰⁹

A further argument in favour of Easson's view that a trust should be liable to tax even if it distributes all of its income is the following. In the case of a discretionary trust, the trustees may decide to retain all of its income in year one, distribute all of its income in year two and distribute a portion of its income (retaining the rest) in year three. It would seem undesirable that an entity would be regarded as liable to tax in year one when all the income is retained, but not in year two (when all the income is distributed), only to be regarded as liable to tax again in year three (when part of the income is distributed and part of the income is retained).

Baker regards partially transparent entities as "clearly liable to tax on the income on which the entity is liable to tax."¹¹¹⁰ In the case of trusts, this would mean that a trust that is taxed on undistributed income would be liable to tax in relation to that income. Regarding that portion of the income which is taxed in the hands of the beneficiaries only, Baker suggests that a "flow-through" approach should be followed, as it is both "pragmatic and consistent with the Partnership Report".¹¹¹¹

The "flow-through" approach set out in the Partnership Report entails that where a partnership as such does not qualify as a resident because the partnership is not liable to tax, the "partners should be entitled to the benefits of the Conventions entered into by the countries of which they are residents to the extent that they are liable to tax on their share of the partnership income in those countries".¹¹¹² Applying the "flow-through" approach to trusts, as Baker suggests, would presumably entail that the beneficiaries resident in the relevant countries would be entitled to the benefits of the applicable DTTs, to the extent that they are liable to tax on the income distributed to them.

Although Baker's view is attractive, a point made earlier should be borne in mind, namely that the OECD MTC does not require that a resident of a state be liable to tax on a specific item of income in order to claim treaty benefits regarding that income. Assume that a trust retains part of its income and distributes the remainder of its income. The trust is taxable on the undistributed portion of the income and would therefore be liable to tax for purposes of the DTT. The fact that a portion of its income is distributed and therefore taxed in the hands of the beneficiaries, will not alter the fact that the trust is liable to tax.¹¹¹³

There is a dissenting view regarding the meaning of the term liable to tax which should be borne in mind here. According to Lang,¹¹¹⁴ if tax-exempt persons can be regarded as liable to

¹¹⁰⁹ Easson in *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* 12:14.

¹¹¹⁰ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 1B.30.

¹¹¹¹ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* 1B.30.

¹¹¹² OECD *The Application of The OECD Model Tax Convention to Partnerships* para 47. The commentary to art 1 of the OECD MTC.

¹¹¹³ In practice, it may be very difficult to determine what income was retained and what income was distributed. See Honiball and Olivier *The Taxation of Trusts in South Africa* 287 who support the point that a trust will be regarded as liable to tax even if it is taxed only on retained income.

¹¹¹⁴ Lang (2001) 55 *BFIT* 596.

tax, then persons who are not considered taxable entities should also be regarded as liable to tax. In his view, it should be irrelevant whether a person is first regarded as taxable and then granted exemption, or whether a person is not considered a taxpayer at all. He argues that the words “by reasons of his domicile, residence, place of management or any other criterion of similar nature” does not mean that the criteria mentioned are the cause of tax liability itself. His reason is that the rule could then not be applied in states who tax on the basis of the principle of territoriality, because the tax treatment in these states does not depend on these criteria. He argues that “other criterion of a similar nature” should entail criteria that imply a similarly close connection to the state, such as domicile, residence or place of management. He concludes that

“[a]s a result, every person having his domicile, residence, place of management or other criterion of a similar nature which expresses a similarly close relation to that state is considered liable to tax and therefore a “resident”. Neither actual taxation nor the qualification as a taxable entity is a requirement for residence under Art. 4(1) of the OECD Model.”¹¹¹⁵

He furthermore states:

“According to the language of the distributive norms of the OECD Model, however, the other contracting state requires only that the person to whom income is allocated according to the laws of the source state be a resident. It is irrelevant whether the income is taxed in the hands of the resident person, in the hands of another taxpayer, or not at all. It is only relevant whether the person to whom the income is allocated according to the laws of the source state has a close enough connection to the other contracting state so that he can be considered a resident there.”¹¹¹⁶

In terms of Lang’s view, it would therefore be irrelevant that trusts are transparent (or any degree thereof). As long as the trust has a close enough connection to the residence state to be considered a resident, it should be able to qualify as a resident for purposes of the treaty. If Lang’s view is followed, a completely transparent trust would still be regarded as a resident for treaty purposes. Similarly, partially transparent trusts would also be regarded as residents.¹¹¹⁷

Support for Lang’s view is provided by Vogel, who states that if an entity is a “person” within the meaning of article 3(1) of the OECD MTC, but is not taxed in its residence state, it should be considered a resident “to the extent that its physical connection with the contracting State satisfies those criteria which, if a tax liability existed, would cause the organization to be taxable as a resident”.¹¹¹⁸

Lang’s view is criticised by Danon and it is submitted that this criticism is justified. Danon argues that the wording of article 4(1), which uses the words “is liable to tax” (own

¹¹¹⁵ Lang (2001) 55 *BFIT* 596 598.

¹¹¹⁶ Lang (2001) 55 *BFIT* 596 599.

¹¹¹⁷ The fact that in South Africa income to which a beneficiary has a vested right (or obtained a vested right due to the exercise by the trustees of their discretion in favour of the beneficiary in that year) never forms part of the income of the trust and is deemed to have accrued to the beneficiary, will be irrelevant, in Lang’s view, and the trust will still be regarded as a resident.

¹¹¹⁸ Vogel *et al* *Klaus Vogel on Double Taxation Conventions* 95.

emphasis), rather than “could be liable to tax”, indicates that the person claiming the benefits of the DTT should be regarded as a taxable person by the residence state. Furthermore, the term liable to tax should be interpreted under the domestic law of the residence state¹¹¹⁹ and not by reference to another DTT provision.¹¹²⁰ Lang’s view is also contrary to the Partnership Report, the view of the majority of academics referred to above and the decision in *Crown Forest Industries*.¹¹²¹

Edwardes-Ker’s approach focuses on what he calls “taxability”. In his view, it should be irrelevant whether an entity qualifies as a “person” for purposes of the OECD MTC. The only relevant consideration to determine whether an entity may claim treaty benefits is “taxability”, by which he means that an entity is taxable or liable to tax.¹¹²² Regarding trusts, he suggests that if a trust is taxable on income (for example, if income is accumulated) in its residence state, then it should be regarded as a resident of that state for treaty purposes. However, if the trust is not taxable on income (because it passes through to the beneficiaries or belongs to the beneficiaries), the trust should not be able to claim treaty benefits. Only the beneficiaries, who are taxable on the income in their resident states should be entitled to claim treaty benefits under the relevant treaties.¹¹²³ Danon interprets Edwardes-Ker’s view to mean that in cases where the trust is allowed to deduct its distributions from its income (as is the case in Canada), the trust will not be regarded as “taxable” and therefore not a resident. Danon criticises Edwardes-Ker’s view, because it conflicts with both the wording of article 4(1) and its goal.¹¹²⁴

Koele classifies trusts that are taxed under the systems found in the United Kingdom and Canada as “semi-transparent” and trusts that are taxed under the system found in South Africa as transparent. She states that in the case of “semi-transparent” trusts, although the trustee is liable to tax, the tax due is “neutralised” by either a simultaneous deduction of the distributed income, or by a credit to the beneficiary, suggesting that the trustee might not, in fact, be liable to tax.¹¹²⁵

It is suggested that closer consideration¹¹²⁶ of the domestic system applied to a particular trust is required in order to ascertain whether a partially transparent entity should be regarded as liable to tax.

In South Africa, a trust is regarded as a person and is taxed at a specific tax rate for trusts. A trust is obliged to file a tax return and the trustees are regarded as the representative

¹¹¹⁹ By virtue of the words “under the laws of that State”.

¹¹²⁰ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 285.

¹¹²¹ *Crown Forest Industries Ltd v The Queen* [1995] 2 SCR 802 a case that is discussed in more detail at ch 6.2.3.

¹¹²² Edwardes-Ker *Tax Treaty Interpretation* para 50.03.

¹¹²³ Edwardes-Ker *Tax Treaty Interpretation* para 51.12.

¹¹²⁴ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 277. It is submitted that Danon’s interpretation of Edwardes-Ker’s view could be extended to systems that allow for a credit (as is the case in the United Kingdom) or which simply initially elect not to tax the trust if a beneficiary is entitled to the income (as is the case in South Africa).

¹¹²⁵ Koele in *The Trust: Bridge or Abyss between Common and Civil Law Jurisdictions* 88.

¹¹²⁶ Ch 3 of this dissertation provides an overview of the taxation of trusts in each of the relevant states. Only a few salient points are highlighted here in order to make the point in this paragraph. Inevitably, this paragraph will repeat some of the content of ch 3.

taxpayers of the trust.¹¹²⁷ The income (and associated expenditure which may be deducted) is taxed either in the hands of the trust, or the hands of the beneficiaries. If taxed in the hands of the trust, the personal circumstances of the beneficiaries are not taken into account to determine the trust's tax liability.¹¹²⁸ Income that is taxed in the hands of the trust and later distributed, will probably not retain its nature. Income that is taxed in the hands of the beneficiary simply passes through the trust and retains its nature.¹¹²⁹ Therefore, in respect of income that is taxed in the hands of the trust, the trust is liable to tax for purposes of article 4(1) of the OECD MTC. This conclusion is reinforced if the above quoted test in the Partnership Report for determining whether a partnership is liable to tax, namely that the personal characteristics of the beneficiaries are not taken into account to determine the trust's tax liability, is applied to trusts. Furthermore, the fact that the personal circumstances of the beneficiaries are irrelevant in the computation of the trust's tax liability, indicate that the trust is liable to tax.

In respect of income that is not retained in the trust, but distributed to the beneficiary and taxed at the level of the beneficiary, it is arguable that a trust should not be regarded as liable to tax. In such a case the income does not form part of the trust's taxable income at all, but simply flows through the trust. In respect of charities, it was stated above that the effect of the OECD MTC appears to be that, if domestic legislation first imposes a liability to tax and then reduces it, the person will be liable to tax. If, however, no tax is imposed from the start, a person will not be regarded as liable to tax. Applying this line of reasoning to trusts it may be argued that since the income that is distributed to beneficiaries never forms part of the trust's income, the trust does not have an initial liability to tax. Hence, it will not be regarded as liable to tax. Furthermore, the personal characteristics of the beneficiaries determine the amount of tax payable and the relevant income retains its nature.

However, reference should again be made to the point that there is no need for a trust to be liable to tax on a specific item of income in order to claim treaty benefits regarding that income. If a trust is regarded as liable to tax in respect of income taxed in the trust (that is, retained income), it will be regarded as liable to tax and there is no need to label a specific item of income as income taxed in the hands of the trust or in the hands of the beneficiary, in order for the trust to claim treaty benefits in respect of that specific income. If the trust is liable to tax on some income, it will be liable to tax on all income.¹¹³⁰ It is submitted that if a trust is a discretionary trust, the trust will, arguably, be regarded as liable to tax on this basis,

¹¹²⁷ See ch 3.2.1.

¹¹²⁸ See ch 3.2.2.

¹¹²⁹ See ch 3.2.3.

¹¹³⁰ Some support for this point may be gleaned from Danon, who argues that New Zealand trustees will be regarded as liable to tax for purposes of art 4(1) of the OECD MTC. New Zealand taxes the trustees, rather than the trust itself, but it is submitted that this difference is irrelevant for the point made here. New Zealand follows the same basic system as South Africa, in that trust income is either taxed in the hands of the beneficiary, or in the hands of the trustee. If a trustee derives income which is not paid to the beneficiary within six months after the end of the tax year or which does not vest absolutely in interest in a beneficiary, the trustees are liable to pay tax on that income. The trustees, if there is more than one, are taxable as a single unit. According to Danon "... it seems obvious that a trustee may be considered 'liable to tax' within the meaning of Art 4 para. 1 ..." (Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 282).

even in years in which the trustees resolve to distribute all of the trust's income.¹¹³¹ The reason for this submission is that if the trustees did not exercise their discretion, the trust would have been liable to tax. The tax system therefore provides for the possible liability to tax of the trust. The determining factor is the exercise of their discretion by the trustees.¹¹³²

In the United Kingdom the trustees are together treated as if they were a single person, distinct from the persons who are the trustees of the settlement from time to time.¹¹³³ In the case of discretionary trusts, the trustee is liable to tax on income arising in the trust.¹¹³⁴ If the trustee distributes income to a beneficiary, the beneficiary is taxed on the distribution, but is entitled to a credit for the tax paid by the trustee. Generally, the trust will be the source of the income and not the underlying assets.¹¹³⁵ In the case of a fixed trust the trustee of a trust is, in principle, liable to tax on the income received by him or her, although there are exceptions to this principle, for example, when the trustee mandates income to a beneficiary.¹¹³⁶ Although the beneficiary of a fixed trust is also liable to tax on the income received from the trust, the beneficiary is, broadly speaking, entitled to a credit for taxes paid by the trustee. If the beneficiary receives income from an English law trust, the underlying assets, and not the trust itself, is regarded as the source of the income. The opposite is true in the case of income from a trust in the "Garland" jurisdictions.¹¹³⁷

It seems reasonably clear that the trustees are liable to tax for purposes of article 4(1) of the OECD MTC. The trustees are regarded as a single person, distinct from the trustees from time to time. Applying the Partnership Report to trusts, it is clear that in the United Kingdom the personal characteristics of the beneficiaries do not influence the tax payable by the trust. The characterisation of the beneficiary's income is controversial. In some trusts the income retains its nature, whereas in other trusts the trust is regarded as the source of the income. Furthermore, the amount that will ultimately be taxed in the hands of the beneficiary does, initially, form part of the income of the trustee. As in the case of exempt entities, one could argue that where the income is initially included in the trustee's income, the trustees will be regarded as liable to tax. Therefore, even if all or part of the trustees' income is distributed to beneficiaries, the trustees will be regarded as liable to tax.

In Canada, a trust is a taxpayer and deemed to be an individual.¹¹³⁸ The trust's taxable income is computed without reference to the beneficiaries' circumstances. A trust is taxable on its income, but the trust is allowed a deduction for the amounts distributed to a beneficiary.¹¹³⁹ The amount is then, generally, included in the income of the beneficiary.¹¹⁴⁰ Income distributed to a beneficiary generally loses its character. Therefore, even though

¹¹³¹ Support for this view may be found in Honiball and Olivier *The Taxation of Trusts in South Africa* 287.

¹¹³² The case of a trust where all the income is vested in the beneficiary, eg, by virtue of the trust instrument (that is a vesting trust), differs from a discretionary trust, in that the tax system does not provide for the trust to be liable to tax at all in the circumstances. The view taken in this dissertation is that a vesting trust is transparent.

¹¹³³ Income Tax Act 2007 s 474(1).

¹¹³⁴ See ch 3.3.2.1.1.

¹¹³⁵ See ch 3.3.2.2.1.

¹¹³⁶ See ch 3.3.3.1.

¹¹³⁷ See ch 3.3.3.2.

¹¹³⁸ See ch 3.4.1.

¹¹³⁹ See cg 3.4.2.

¹¹⁴⁰ See ch 3.4.3.

trusts may derive income from a variety of sources, when distributed to beneficiaries, it will not retain its nature and beneficiaries will report the income that they receive simply as income stemming from an interest in a trust.¹¹⁴¹ Trusts may not allocate losses to beneficiaries.¹¹⁴²

It therefore seems reasonably clear that a trust is liable to tax for purposes of article 4(1) of the OECD MTC. Applying the Partnership Report to trusts, it is clear that in Canada the personal characteristics of the beneficiaries do not influence the tax payable by the trust and income, generally, does not retain its nature when distributed to beneficiaries.¹¹⁴³ Furthermore, the amount that will ultimately be taxed in the hands of the beneficiary does, in fact, initially form part of the income of the trust. As in the case of exempt entities, it may be argued that where the income is included in the trust's income from the start, the trust will be regarded as liable to tax. Therefore, even if all or part of the trust income is distributed to beneficiaries, the trust will be regarded as liable to tax.

Taking stock of all the arguments presented above, it is submitted that there is merit in regarding a partially transparent trust (or trustee) as liable to tax, even in circumstances where all its income is distributed,¹¹⁴⁴ and it is submitted that this approach may, arguably, be theoretically sounder. However, Baker's approach seems the more practical solution to this conundrum. In terms of this approach a trust(ee) that is taxed on undistributed income would be liable to tax in relation to that income. Regarding that portion of the income that is taxed in the hands of the beneficiaries, the beneficiaries resident in the relevant countries would be entitled to the benefits of the applicable conventions, to the extent that they are liable to tax on the income distributed to them.

The OECD has also produced subsequent reports to the Partnership Report and it is examined below whether these reports may shed light on how the liable to tax requirement should be applied to transparent entities.¹¹⁴⁵ In a report entitled *Tax Treaty Issues Related to REITS* (the REITS Report), the OECD described a REIT as "a widely held company, trust or contractual or fiduciary arrangement that derives its income primarily from long-term investment in immovable property (real estate), distributes most of that income annually and does not pay income tax on income related to immovable property that is so distributed".¹¹⁴⁶ The OECD acknowledged that there are considerable differences between countries regarding the way in which REITS are structured and the manner in which the

¹¹⁴¹ See ch 3.4.4, although there are important exceptions to this rule.

¹¹⁴² See ch 3.4.2.

¹¹⁴³ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 276.

¹¹⁴⁴ Analysing the different domestic tax laws of each state, this argument is a bit harder to make in terms of South African tax law, since the income that is attributed to the beneficiary is not taxed in the trust at all. However, if Lang's view is followed, this would be irrelevant.

¹¹⁴⁵ The OECD has also issued a report entitled "OECD Discussion Draft on the Application of Tax Treaties to State-owned Entities, Including Sovereign Wealth Funds", which is not discussed in this dissertation, as it is submitted that this report does not add any new insight regarding the liable to tax requirement.

¹¹⁴⁶ OECD *Tax Treaty Issues Related to REITS Public Discussion Draft* para 3. Naturally, only certain relevant aspects of the REITS Report are discussed in this dissertation.

exemption of their income is achieved.¹¹⁴⁷ In respect of the treaty entitlement of a REIT, the report states:

“It seems, however, that in most cases, the REIT would meet the condition of being liable to tax for purposes of the treaty definition of ‘resident of a Contracting State’, subject to the particular problems arising from the application of tax treaties to trusts.”¹¹⁴⁸

The report, after noting that the investors in REITS will, in most cases, be entitled to the benefits of the DTT entered into by their resident states,¹¹⁴⁹ goes on to answer the question of who the relevant taxpayer is for purposes of the DTT. In cases where the REIT is treated as a transparent entity, the principles of the Partnership Report must be followed. In countries where the REIT is not treated as transparent, the REIT itself will be the relevant taxpayer.¹¹⁵⁰ Since the REIT does not pay income tax in its residence state (to the extent that it is distributed), difficulties may arise in relation to the application of relief from double taxation either in the domestic law or in tax treaties. The report therefore states that it is considered appropriate for the state of residence to allow relief from double taxation that the source state has levied on the REIT, even if the residence state taxes the investor and not the REIT itself.¹¹⁵¹ Furthermore, all distributions by REITS are to be classified as dividends irrespective of the legal form that the REIT may take.¹¹⁵² Thus, distributions by a REIT that is structured as a trust, will be treated as dividends, even though a trust could not possibly declare dividends.

In a report regarding the granting of treaty benefits with respect to the income of collective investment vehicles (the CIV Report),¹¹⁵³ the OECD states that portfolio investors in securities often pool their funds with other investors in collective investment vehicles (CIVs) and that these CIVs may take different forms, including trusts.¹¹⁵⁴ The OECD recognises that there are substantial differences between countries regarding the tax treatment of CIVs, with some states regarding CIVs as transparent and others regarding them as opaque. The goal in most countries is, however, that tax is levied only at one level, that is, either at the CIV level, or the investor level.¹¹⁵⁵ The CIV Report confirms that in countries that view the CIV as transparent for tax purposes or that totally and unconditionally exempt CIVs from taxation, the CIV will not be regarded as liable to tax. In countries where the CIV is regarded as opaque, it will be liable to tax, despite the fact that specific items of income may be exempt, that it is subject to a lower rate of tax, or that it receives a deduction for dividends

¹¹⁴⁷ OECD *Tax Treaty Issues Related to REITS Public Discussion Draft* para 4.

¹¹⁴⁸ OECD *Tax Treaty Issues Related to REITS Public Discussion Draft* para 9.

¹¹⁴⁹ OECD *Tax Treaty Issues Related to REITS Public Discussion Draft* para 10.

¹¹⁵⁰ OECD *Tax Treaty Issues Related to REITS Public Discussion Draft* para 15.

¹¹⁵¹ OECD *Tax Treaty Issues Related to REITS Public Discussion Draft* para 16.

¹¹⁵² OECD *Tax Treaty Issues Related to REITS Public Discussion Draft* para 28.

¹¹⁵³ OECD R(24). *The granting of treaty benefits with respect to the income of collective investment vehicles*. Once again, only the relevant aspects of this report are mentioned in this dissertation.

¹¹⁵⁴ OECD R(24). *The granting of treaty benefits with respect to the income of collective investment vehicles* para 1.

¹¹⁵⁵ OECD R(24). *The granting of treaty benefits with respect to the income of collective investment vehicles* paras 27–28.

paid to investors.¹¹⁵⁶ In countries where the CIV is not liable to tax, investors should be able to claim treaty benefits, but because of administrative difficulties, this cannot be achieved. Hence, the report suggests that CIVs should be able to claim the benefits of a DTT on behalf of its investors.¹¹⁵⁷

In answering the question of whether a partially transparent entity will be liable to tax and therefore a resident for purposes of a treaty, little guidance is provided by the OECD REITS Report and the CIV Report. The Partnership Report, although it specifically states that it does not apply to flow-through entities, seems to offer the greatest assistance.

6.2.2.3.4 Conclusion regarding transparency

Reviewing the position of a trust(ee), their transparency and the liable to tax requirement, the following points may be deduced:

- (a) A trust(ee) that is completely transparent or transparent with reporting requirements (items (a) and (b) above) will not be regarded as liable to tax and therefore cannot be a resident for purposes of the treaty.
- (b) A trust(ee) that is completely opaque will be regarded as liable to tax. Generally speaking, if no income has been distributed to a beneficiary, a trust will be regarded as opaque in South Africa, the United Kingdom and Canada.
- (c) A trust(ee) that is partially transparent should, it is submitted, be liable to tax in respect of income on which it is taxed (that is, income which they retain) and beneficiaries should be liable to tax on income on which they are taxed (that is, income that is distributed to them).

6.2.2.4 Trust income deemed to be that of another¹¹⁵⁸

A further point that must be considered is the influence of provisions which deem the income of one entity to be that of another person for tax purposes. Typically, in the case of a trust, the income of the trust is deemed to be that of the settlor. Examples of these types of provisions can be found in South Africa,¹¹⁵⁹ the United Kingdom,¹¹⁶⁰ Canada¹¹⁶¹ and the Netherlands.¹¹⁶² The question that arises is whether a trust(ee) will be regarded as liable to tax if its income is deemed to be that of the settlor for tax purposes.

In answering this question, it should be borne in mind that these deeming provisions sometimes attribute only certain amounts of income to the settlor. For example, in terms of certain provisions in the relevant South African legislation, only income that is received by or

¹¹⁵⁶ OECD R(24). *The granting of treaty benefits with respect to the income of collective investment vehicles* para 29.

¹¹⁵⁷ OECD R(24). *The granting of treaty benefits with respect to the income of collective investment vehicles* paras 36–40.

¹¹⁵⁸ The question whether the person to whom the income is attributed may claim treaty benefits falls outside the scope of this dissertation.

¹¹⁵⁹ Income Tax Act 58 of 1962 s 7. See ch 3.2.4.

¹¹⁶⁰ Income Tax (Trading and Other Income) Act 2005 s 624. See ch 3.3.4.

¹¹⁶¹ Income Tax Act RSC 1985 (5th supp) ch 1 s 75(2). See ch 3.4.5.

¹¹⁶² *Wet inkomstenbelasting* 2001 s 2.14a. See ch 3.5.

accrued to a trust by reason of or in consequence of a donation, settlement or other disposition, is deemed to have accrued to the donor (typically the settlor).¹¹⁶³ Therefore, other income, which does not accrue to the trust by reason of such donation, settlement or other disposition, will not be affected by the provision and the trust will therefore still be liable to tax on those amounts. A further example can be found in a provision in the South African legislation that attributes income received by or accrued to or in favour of a trust for the benefit of a minor child, to the child's parent (usually the settlor of the trust), under certain circumstances.¹¹⁶⁴ If there are both minor and major children of the parent who are beneficiaries of the trust, then all the trust's income will not be attributed to the parent. Since the trust may still be liable to tax on income that is not attributable to the settlor, the trust may still be liable to tax for purposes of the treaty.¹¹⁶⁵

This point is echoed by Danon, who states:

"In our opinion, these rules do not affect nor concern the issue of residence under a DT[T] patterned upon the OECD M[T]C. Indeed, by simply referring to a person 'liable to tax', Art 4 para 1 OECD M[T]C merely requires a subjective tax liability of the person claiming the DT[T] benefits. That is, not only is it irrelevant for this purpose whether the person effectively pays taxes in the residence State, it is also immaterial whether the treaty favoured income is fiscally attributed to this person. In other words, this provision does not focus on particular income streams, treating a taxpayer as a resident in respect of one income stream and not the other."¹¹⁶⁶

According to Lang's view regarding the meaning of liable to tax, it does not matter that the income is not taxed in the hands of the trust (or trustee), but rather in the hands of the settlor. All that is relevant is that the person to whom the income is allocated according to the laws of the source state (that is, the trust) has a close enough connection to the other contracting state so that he can be considered a resident there.¹¹⁶⁷

The Tax Court of Canada, in *Garron v R*,¹¹⁶⁸ dealt with the issue of income of the trust being deemed to be that of another and its effect on treaty entitlement, by referring to the wording of the specific provision of the treaty, as well as its objectives. The case is discussed below in greater detail,¹¹⁶⁹ but the relevant facts were that two trusts were held liable for capital gains tax on the sale of certain shares. The applicable Canadian legislation contained

¹¹⁶³ Eg Income Tax Act 58 of 1962 ss 7(2), (3), (4) and (8).

¹¹⁶⁴ Income Tax Act 58 of 1962 s 7(3), which reads as follows: "Income shall be deemed to have been received by the parent of any minor child or stepchild, if, by reason of any donation, settlement or other disposition made by that parent of that child, (a) it has been received by or has accrued to or in favour of that child or has been expended for the maintenance, education or benefit of that child; or (b) it has been accumulated for the benefit of that child."

¹¹⁶⁵ It serves to repeat here that there is no requirement for a resident of a state to be liable to tax on a specific item of income in order to claim treaty benefits regarding that income.

¹¹⁶⁶ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 279.

¹¹⁶⁷ Lang (2001) 55 *BFIT* 596 599.

¹¹⁶⁸ *Garron v R* 2009 TCC 450; 12 *ITLR* 79. Although this case went on appeal, first to the Federal Court of Appeal (*St Michael Trust Corp as Trustee of the Fundy Settlement v Her Majesty the Queen* 2010 FCA 309) and then to the Supreme Court of Canada (*Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520), these appeal judgements did not deal with this specific issue.

¹¹⁶⁹ See ch 6.3.3.1.

a provision that would, under certain circumstances, attribute the gain to the main beneficiaries of the trusts. The trustee of the trusts argued that the following provision in the relevant DTT prevented Canada from taxing the gain in the hands of the trust:

“Gains from the alienation of any property, other than those mentioned in paragraphs 1, 2 and 3, may be taxed only in the Contracting State of which the alienator is a resident.”¹¹⁷⁰

Although neither the Canadian government nor the main beneficiaries argued that this provision in the DTT would prevent Canada from taxing the main beneficiaries in terms of the legislation that deemed the gain to be that of the main beneficiaries, the court held that it did. The court held that the plain language of the provision meant that gains realised from the alienation of property by trusts resident only in Barbados may not be taxed in Canada. Furthermore it held that the provision is unambiguous and broad enough to apply to an attribution provision.¹¹⁷¹ It also stated that the primary objective of the treaty was to minimise the potential for double taxation and that interpreting the treaty in a way that would allow Canada to tax the main beneficiaries would defeat this objective.¹¹⁷²

The Canadian Federal Court of Appeal also held, *obiter*, that the provision deeming the gains of an Austrian Private Foundation (“*Privatstiftung*”) to be that of a beneficiary, could not be applied, due to the application of the DTT between Canada and Austria. In *Her Majesty the Queen v Peter Sommerer*,¹¹⁷³ the taxpayer’s father formed a private foundation in Austria. The taxpayer, his wife and children were potential beneficiaries and the ultimate beneficiaries of the private foundation. The taxpayer had, on two separate occasions, sold shares to the private foundation and the private foundation had, in turn, sold the shares to third parties, realising capital gains. The question in the case was whether the capital gain could be attributed to the taxpayer in terms of the relevant Canadian legislation. The court found that it could not, but nevertheless continued to examine the effect of the provisions of the applicable DTT on such an attribution to the taxpayer. The court held that the provisions of the DTT prevented Canada from taxing the taxpayer on the gain (if it were to be attributed to him). It held that attribution provisions usually give rise to problems of economic double taxation, rather than juridical double taxation. The DTT could not be interpreted in such a manner that economic double taxation was excluded from the outset.¹¹⁷⁴ It also confirmed the court *a quo*’s view that the attributed gain fell within the literal meaning of the wording of the relevant provision of the DTT.¹¹⁷⁵

¹¹⁷⁰ *Garron v R* 2009 TCC 450; 12 ITLR 79 para 330.

¹¹⁷¹ *Garron v R* 2009 TCC 450; 12 ITLR 79 para 331.

¹¹⁷² *Garron v R* 2009 TCC 450; 12 ITLR 79 paras 333–337.

¹¹⁷³ *Her Majesty the Queen v Peter Sommerer* 2012 FCA 207. The Income Tax Act RSC 1985 (5th supp) ch 1 has since been amended in response to the *Sommerer* case. S 75(2) was unchanged, but s 94 was amended (see Falk and Morand “Budget 2013: A Response to Sommerer”

<http://www.mccarthy.ca/article_detail.aspx?id=6260> (accessed on 04/11/2013) for a discussion of these amendments). See ch 6.3.3.2 for a discussion of s 94(3) and the amendment.

¹¹⁷⁴ *Her Majesty the Queen v Peter Sommerer* 2012 FCA 207 paras 66–67.

¹¹⁷⁵ *Her Majesty the Queen v Peter Sommerer* 2012 FCA 207 para 62.

In the *Smallwood* case¹¹⁷⁶ (which is also discussed below in greater detail) the same type of deeming provision was applied, but the court never addressed the point that the settlor of the trust would be taxed and not the trustees.

6.2.3 By reason of certain factors

Article 4 states that a person is a resident of a contracting state if the person is liable to tax under domestic law *by reason of* his domicile, residence, place of management or any other criterion of a similar nature. According to Baker the intention of the OECD MTC is to refer to recognised criteria for imposing comprehensive taxation.¹¹⁷⁷ It is important to note that each of the criteria mentioned in article 4 refers to domestic tax law terms, which must be interpreted in accordance with the domestic law of the particular state.¹¹⁷⁸

One of the criteria listed in the article is that of “place of management”. This criterion must be distinguished from “place of effective management” (POEM), as found in article 4(3) of the OECD MTC. The distinction is based on the different purposes for which the two concepts are used. The first is used to include “all forms of unlimited liability to tax which are based on effective, externally visible criteria”.¹¹⁷⁹ The latter is used in order to avoid double residence for treaty purposes. Hence, an autonomous meaning should be given to the concept of POEM, whilst “place of management” is to be interpreted in accordance with domestic law.¹¹⁸⁰

The Canadian case of *Crown Forest Industries*¹¹⁸¹ turned on the words “by reason of” and the criteria that follow. In that case a Canadian company, Crown Forest Industries, paid rental to a company, Norsk, which was incorporated in the Bahamas. Norsk’s only office and place of business was, however, in the USA. Norsk never paid tax in the Bahamas and, due to a specific exemption for which it qualified in the USA, never paid tax in the USA either. Canada levied a withholding tax of 25 per cent on the rental paid to Norsk, but Crown Forest Industries claimed that the treaty between Canada and the USA reduced the rate to ten per cent. The issue to be determined by the court was whether Norsk qualified as a resident of the USA for purposes of the Canada-USA treaty, which contained an article similar to article 4(1) of the OECD MTC. In terms of the Internal Revenue Code in the USA, Norsk, as a foreign corporation, was taxed on its taxable income from the conduct of a trade or business within the USA. The Internal Revenue Code went on to exempt certain amounts, Norsk falling within one of these exemptions.

In determining whether Norsk was a resident of the USA, the court had to decide whether Norsk was liable to tax in the USA by reason of its domicile, residence, place of management or any other criterion of a similar nature. The court highlighted that liability to taxation must be *by reason of* one of the listed grounds, stating that that phrase “connotes the existence of

¹¹⁷⁶ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778.

¹¹⁷⁷ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 4B.06.

¹¹⁷⁸ Widrig in *Residence of Companies under Tax Treaties and EC Law* 274; Vogel *et al Klaus Vogel on Double Taxation Conventions* 230. For a contrary view see Couzin *Corporate Residence and International Taxation* 135.

¹¹⁷⁹ Widrig in *Residence of Companies under Tax Treaties and EC Law* 278.

¹¹⁸⁰ Widrig in *Residence of Companies under Tax Treaties and EC Law* 278.

¹¹⁸¹ *Crown Forest Industries Ltd v The Queen* [1995] 2 SCR 802.

some sort of causal connection or, in the least, some relationship of proximity”.¹¹⁸² The court held that the fact that Norsk had its place of management in the USA was not causally or proximately linked to the basis on which Norsk was taxed in the USA. Norsk’s tax liability in the US arose because it conducted a trade or business which was effectively connected to the USA. Norsk’s place of management was but one of many factors which was used to determine Norsk’s liability to taxation and could not be elevated to an actual ground for liability.

The court considered whether the ground for liability in the USA, namely conduct of a trade or business effectively connected with the USA, could be regarded as a “criterion of a similar nature” to the other ones enumerated in article 4(1) and that Norsk would hence be a resident of the USA. The court found that the “similar element among the enumerated criteria is that, standing alone, they would each constitute a basis on which states generally impose full tax liability on world-wide income”.¹¹⁸³ Furthermore the court held that the criteria set out in article 4(1) involved more than just being liable to tax on some part of income. Rather, these criteria require comprehensive tax liability imposed by a state which, in the case of the USA, is liability on a worldwide basis. Norsk’s liability in the USA was limited to source liability and therefore the criterion of conduct of a trade or business within the USA did not amount to one similar to the enumerated criteria.¹¹⁸⁴

The *Crown Forest Industries* case therefore indicates that there should be a causal link or some relationship of proximity between the grounds for tax liability in a state and the criteria enumerated in article 4(1). The case furthermore indicates that the enumerated criteria connote comprehensive liability imposed by a state and that any basis of taxation which is to be classified as a “criterion of a similar nature” should also involve comprehensive liability and not just source-based taxation.

Regarding the last point, the Canadian courts have considered a case in which the question was whether a trust is liable to tax by reason of its residence.¹¹⁸⁵ In this case, the relevant treaty article contained the same wording as article 4(1) of the OECD MTC. The applicable Canadian legislation deemed a trust to be a resident if certain conditions were met.¹¹⁸⁶ Both the Tax Court of Canada¹¹⁸⁷ and the Canadian Federal Court¹¹⁸⁸ agreed that if the deeming provisions applied, the scheme of taxation to which the trust would be liable, was more limited than the scheme of taxation applying to trusts resident under the general principles. Thus it was held that if the deeming provisions applied, the trust would not be liable to tax

¹¹⁸² *Crown Forest Industries Ltd v The Queen* [1995] 2 SCR 802 para 25.

¹¹⁸³ *Crown Forest Industries Ltd v The Queen* [1995] 2 SCR 802 para 40.

¹¹⁸⁴ *Crown Forest Industries Ltd v The Queen* [1995] 2 SCR 802 para 40. The court also held, in the second part of the judgement, that the intention of the drafters of the convention indicated that Norsk should not be regarded as a resident.

¹¹⁸⁵ *Garron v R* 2009 TCC 450; 12 ITLR 79; *St Michael Trust Corp as Trustee of the Fundy Settlement v Her Majesty the Queen* 2010 FCA 309. This case is discussed in greater detail in ch 6.3.3.1.

¹¹⁸⁶ The latest version of the legislation is discussed in greater detail in ch 6.3.3.2. The case was decided on an earlier version of the relevant section.

¹¹⁸⁷ *Garron v R* 2009 TCC 450; 12 ITLR 79 para 316.

¹¹⁸⁸ *St Michael Trust Corp as Trustee of the Fundy Settlement v Her Majesty the Queen* 2010 FCA 309 para 87. Although the matter went on appeal to the Supreme Court of Canada (*Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520), this point was not decided by that court.

by reason of its residence.¹¹⁸⁹ Prior to this case it was suggested in academic literature that it would be difficult to argue that the relevant deeming provision did not result in comprehensive taxation as envisaged in *Crown Forest Industries*. However, it was argued that the deeming provision would not result in liability *by reason of* the trust's domicile, residence, place of management, place of incorporation or any other criterion of a similar nature. Liability would simply arise by reason of the deeming provision.¹¹⁹⁰

According to some authors, the phrase "criterion of a similar nature" does not only connote comprehensive liability to tax. They submit that it should also be interpreted in the context of the terms "domicile", "residence" and "place of management", meaning not only that the criterion should be similar, but also that it should have a certain local connection, as do the other three criteria.¹¹⁹¹

In *Robert MO Morris and Neville Leroy Smith Trustees of the RCI Trust v Minister of National Revenue*,¹¹⁹² the Canadian Federal Court held that any other criterion of a similar nature "would include other aspects of actual physical presence and not more esoteric concepts such as deemed residence".¹¹⁹³ The court was asked to find that the trust was not only resident in Barbados (which the Minister conceded), but that it was also a resident of Canada, thereby applying the tiebreaker in article 4(3) of the relevant DTT. However, the court held that article 4(3) required residence in terms of article 4(1) and, because there were no "actual physical factors", such as domicile, residence or place of management linking the trust to Canada, that it was not a resident in Canada.

An issue that has led to academic debate is whether incorporation of a juristic person should be regarded as a "criterion of a similar nature".¹¹⁹⁴ Some states regard an entity as resident if it is incorporated in that state. One view is that incorporation is not a criterion similar to domicile, residence or POEM because it lacks effective personal attachment to the territory.¹¹⁹⁵ Another view is that incorporation is a criterion of a similar nature because it leads to unlimited liability.¹¹⁹⁶ Working Party No. 2 decided not to expressly include

¹¹⁸⁹ This finding of the court was criticised by Avery Jones and Nikolakakis, stating that the court gave too much weight to the relevant dictum in *Crown Forest Industries*. They argued that if the wording of the treaty means "liable otherwise than on a source basis", the relevant deeming provision would result in such liability (Avery Jones and Nikolakakis (2012) 14 *International Tax Law Reports* 1090 1100).

¹¹⁹⁰ Roth (2004) 52 *Canadian Tax Journal* 329 415. Avery Jones and Nikolakakis seem to support this point, stating that "as a matter of plain words" a person is not liable to tax by reason of the listed criteria in terms of the relevant deeming provision. They continue to ask whether "... in spite of the wording, does it mean not similar in nature but similar in result, that is taxation as a resident ..." (Avery Jones and Nikolakakis (2012) 14 *International Tax Law Reports* 1090 1099).

¹¹⁹¹ Widrig in *Residence of Companies under Tax Treaties and EC Law* 280; Vogel et al *Klaus Vogel on Double Taxation Conventions* 233.

¹¹⁹² *Robert MO Morris and Neville Leroy Smith Trustees of the RCI Trust v Minister of National Revenue* 2009 FC 434.

¹¹⁹³ *Robert MO Morris and Neville Leroy Smith Trustees of the RCI Trust v Minister of National Revenue* 2009 FC 434 para 37.

¹¹⁹⁴ Couzin argues that the place of incorporation could fall under the criterion of domicile (Couzin *Corporate Residence and International Taxation* 136), but prefers the argument that it falls under the residence criterion (Couzin *Corporate Residence and International Taxation* 139).

¹¹⁹⁵ Widrig in *Residence of Companies under Tax Treaties and EC Law* 281; Vogel et al *Klaus Vogel on Double Taxation Conventions* 233.

¹¹⁹⁶ Attard in *History of Tax Treaties The relevance of the OECD Documents for the Interpretation of Tax Treaties* 203.

incorporation as a criterion under article 4(1) and was of the view that incorporation was primarily found in the tax system of the United States and rarely used in other existing bilateral treaties.¹¹⁹⁷

The debate is relevant to trusts, in that South African law provides that a person such as a trust is resident, *inter alia*, if it is incorporated, established or formed in South Africa.¹¹⁹⁸ Quite clearly a trust cannot be incorporated as it is not, generally speaking, a juristic person. It is submitted that the criterion of “established or formed” in South Africa is similar to that of incorporation in that it is a formal criterion, dealing with the coming into being of entities. It is therefore relevant to determine whether the criterion of “established or formed” in relation to trusts will be viewed as a criterion “of a similar nature” for purposes of article 4(1).

It is submitted that the view that formal criteria, such as incorporation or “established or formed”, are criteria of a similar nature, is to be preferred. In the *Crown Forest Industries* case the only requirement set by the court for a criterion to qualify as a “criterion of a similar nature” was that it should lead to comprehensive liability. On this basis, the criterion of “established or formed” in South Africa would also lead to comprehensive taxation and therefore it is submitted that this criterion is of a similar nature to the other enumerated criteria. In any event, the criterion of “established or formed” is merely used to determine whether a trust is resident in South Africa under South African law and the criterion of residence is an explicit criterion.¹¹⁹⁹

It is to be noted that Canada has placed a reservation on article 4 of the OECD MTC to the effect that it may use the place of incorporation or organisation with respect to a company.¹²⁰⁰ South Africa has not entered a similar reservation when stating its position on the relevant article. It is submitted that South Africa should enter such a reservation to ensure that it is able to rely on the criterion of “established or formed” in relation to trusts.

¹¹⁹⁷ Attard in *History of Tax Treaties The relevance of the OECD Documents for the Interpretation of Tax Treaties* 202.

¹¹⁹⁸ The criteria and their application in South Africa to trusts is discussed more fully in ch 6.3.1.

¹¹⁹⁹ Support for this argument may be found in Couzin *Corporate Residence and International Taxation* 139, who argues that the criterion of place of incorporation of companies, which deems a company to be resident, will most likely be accepted as causing liability to tax by reason of residence.

¹²⁰⁰ Commentary on the OECD MTC art 4 para 27. Canada does not use “incorporation” or a similar criterion in relation to trusts. (See ch 6.3.3.)

6.3 Residence under domestic law

6.3.1 South Africa¹²⁰¹

6.3.1.1 The definition of “resident”¹²⁰²

In terms of the Act, a person, other than a natural person,¹²⁰³ is resident in South Africa if:

- (a) it is incorporated, established or formed in South Africa; or
- (b) it has its POEM in South Africa.

However, any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation, is not a resident.¹²⁰⁴ Furthermore, the definition was recently amended by the addition of two proviso's.¹²⁰⁵ The first states that where any person that is a resident ceases to be a resident during a year of assessment, that person must be regarded as not being a resident from the date on which that person ceases to be a resident. The second proviso deals with foreign investment entities and provides that certain activities must be disregarded when determining where a foreign investment entity has its POEM.¹²⁰⁶

¹²⁰¹ This part of the dissertation draws on the research contained in an earlier article (Du Plessis (2009) 21 SA *Merc LJ* 322).

¹²⁰² It is possible for a court to disregard the defined meaning of a term, but this is an exception. (See ch 4.4.1 for the test to determine whether a court may disregard the defined meaning of a term.) The possibility of using another meaning of the term can only be considered and an alternative meaning can only be proposed, if the context within which the term is used is analysed. In this dissertation the possibility of using an alternative meaning to the defined meaning of “residence” is not considered.

¹²⁰³ The Act also lays down the criteria in terms of which a “natural person” is a resident of South Africa. It is submitted that in order to determine whether a trust is a resident in terms of the Act, the criteria for a person other than a natural person should be applied. The reason for this view is that a trust itself is deemed to be a “person” for purposes of the Act (Income Tax Act 58 of 1962 s 1 definition of “person”) and a trust is clearly not an individual. The definition of the term “trust” in the Act clearly does not refer to a natural person (Income Tax Act 58 of 1962 s 1 definition of “trust”). In academic literature the criteria for persons other than natural persons have been applied to trusts without discussion (eg: Van der Merwe (2002) 14 *Residence of a Company - the Meaning of 'Effective Management'* 79 79; Olivier and Honiball *International Tax: a South African Perspective* 153; Hattingh in *Residence of Companies under Tax Treaties and EC Tax Law* 680; Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 337). In *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127 the court also applied the criteria for persons other than individuals when determining the residence of a trust.

¹²⁰⁴ Income Tax Act 58 of 1962 s 1 definition of “resident”. This definition further excludes in paragraph (B) certain companies that qualify as controlled foreign companies.

¹²⁰⁵ Taxation Laws Amendment Act 22 of 2012 s 2(1)(w).

¹²⁰⁶ A “foreign investment entity” is defined as follows: “any person other than a natural person (a) that is not incorporated, established or formed in the Republic; (b) the assets of which consist solely of a portfolio of one or more of the following: (i) amounts in cash or that constitute cash equivalents; (ii) financial instruments that (aa) are issued by a listed company or by the government of the Republic in the national, provincial or local sphere; or (bb) if not issued by a listed company or by the government of the Republic in the national, provincial or local sphere, are traded by members of the general public and a market for that trade exists; (iii) financial instruments, the values of which are determined with reference to financial instruments contemplated in subparagraph (ii); or (iv) rights to receive any asset contemplated in subparagraph (i), (ii) or (iii), which amounts, financial instruments and rights are held by that person for investment purposes; (c)

One of the implications of this definition is that a trust may be a resident in South Africa if it is established or formed in South Africa. Once established or formed in South Africa, its status as a resident (for domestic law purposes) will only be disturbed if it is deemed to be exclusively a resident of another state by virtue of a DTT. If a trust is not established or formed in South Africa, it will be a resident if it has its POEM in South Africa. Once again, a trust that is effectively managed in South Africa will, however, not be a resident if it is deemed to be exclusively a resident of another state for purposes of a DTT.

That particular sentence of the definition of resident, which provides that a person is not a resident if that person is deemed to be exclusively a resident of another country for purposes of a DTT, is crucial and has the effect that a trust, which is regarded as a resident of another state in terms of *any* double tax agreement, will cease to be a resident of South Africa for all purposes. Therefore, in determining the residence of a trust (or any other person), theoretically, all of South Africa's double tax agreements have to be examined to determine whether the trust is deemed to be exclusively a resident of another state. If it is deemed to be exclusively a resident of another state in terms of any double tax agreement, it will not be regarded as a South African resident.

The tiebreaker provisions of the OECD MTC, which would typically be the provision deeming a trust to be exclusively resident in one or the other state, will be discussed below. In the following paragraph the two alternative tests for residence will be analysed.

6.3.1.2 Incorporated, established or formed

6.3.1.2.1 Introduction

A trust is not, generally speaking, a juristic person¹²⁰⁷ and so the word "incorporated" does not apply to trusts. Trusts would rather be "established or formed", but neither of these words is defined in the Act.¹²⁰⁸

It should also be noted that the phrase used in the Act is the following: "incorporated, established or formed *in* the Republic" (own emphasis). This phrase can be interpreted in two possible ways. Firstly, it could mean that the trust is to be established or formed within South Africa's borders. Secondly, it could mean that the trust is to be established or formed in terms of South African law. The second meaning relies on the *noscitur a sociis* rule of interpretation which provides that

where no more than 10 per cent of the shares, units or other form of participatory interest in that person are directly or indirectly held by persons that are residents; and (d) where that person has no employees and has no directors or trustees that are engaged in the management of that person on a full-time basis." According to National Treasury, the reason for this amendment is that many foreign investors (such as pension funds or other institutional investors) use South African investment managers to advise them on their South African and African investments. To ensure that the use of the South African investment manager does not result in the foreign investor being effectively managed in South Africa, a "carve-out" from the POEM test was created. If a foreign investor qualifies as a foreign investment entity, certain services performed by the investment manager, such as financial product advice, will be disregarded when applying the POEM test in relation to the foreign investor (National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012* para 5.11). This provision will only apply in relation to trusts if the South African fund manager operates as a trust, but this possibility is not further investigated in this dissertation.

¹²⁰⁷ See ch 2.2.4.

¹²⁰⁸ See also Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 338.

“the meaning that a linguistic signifier generates can be restricted by other signifiers with which it is associated, irrespective of whether the latter constitute a genus. The signifiers also do not have to fit a scheme of, for instance, general ones preceded by more specific ones.”¹²⁰⁹

Applying this rule, the words “established or formed” must be interpreted to connote a meaning similar to the word with which it is associated, namely “incorporated”. Since the phrase “incorporated ... in the Republic” can only mean incorporated in terms of the law of the Republic, so too must the phrase “established or formed in the Republic” mean that an entity must be formed or established in terms of South African law. Furthermore, it may be argued that from a policy perspective, South Africa should only tax as residents those entities which are formed in terms of South African law (leaving POEM aside for the moment) since the residence basis of taxation is premised on the ground that residents enjoy the protection of the state and should therefore contribute towards the costs of the government of the state in which they reside.¹²¹⁰

In this dissertation, however, the first interpretation (namely that the trust is to be established or formed within South Africa’s borders) is preferred. The reasons for this preference are as follows. The phrase “in the Republic” is used elsewhere in the same definition in the sense of “within South Africa’s borders”, for example in the phrase “if that person was physically present in the Republic”.¹²¹¹ Also, in other sections of the Income Tax Act the phrase clearly means “within South Africa’s borders”.¹²¹² Furthermore, it is submitted that if the legislature intended the words to mean “in terms of South African law”, it would have used words such as those used in the definition of “company”, namely “under any law in force ... in the Republic”.¹²¹³

Although the first interpretation is the preferred one, it is submitted that the interpretation of the words “in the Republic” contained in the phrase “incorporated, established or formed in the Republic” in the definition of “resident”, should be clarified by legislative amendment.

Applying the first interpretation to trusts, it means that only trusts established or formed within the borders of South Africa will qualify as residents under this criterion. *Inter vivos* trusts are usually formed by way of a contract and hence the time and place that the contract is entered into should be established in order to determine the time and place of establishment of the trust. A testamentary trust is formed by way of a will and so the time and place of formation or establishment of a testamentary trust would have to be determined.

¹²⁰⁹ Du Plessis in *LAWSA* para 347.

¹²¹⁰ Support for this argument may be found in Muller *Determining the Residence of a Trust: a South African Income Tax Perspective* 161. She further argues that if the definition of “trust” in the Income Tax Act is read together with the criterion of established or formed, the definition is tailored so that entities created and owing their existence to South African laws, is intended.

¹²¹¹ Income Tax Act 58 of 1962 s 1 definition of resident para (a)(ii).

¹²¹² Eg in ss 9(2), 9H(4)(a), 10(1)(c)(iii), 33(1), 35A(1), 47A, 47B and 47K.

¹²¹³ Income Tax Act 58 of 1962 s 1 definition of “company” paras (a) and (b).

6.3.1.2.2 Time and place of establishment or formation

As set out in an earlier chapter, it is on the date that the settlor and trustee execute the trust deed (or enter into an oral agreement) that the *inter vivos* trust is formed, irrespective of the date on which the beneficiary accepts.¹²¹⁴ A testamentary trust is usually formed at the date of the testator's death.¹²¹⁵

As an *inter vivos* trust is created by way of a contract, the rules on the place of formation of a contract are relevant. The general rule (also known as the "information theory") provides that a contract is concluded at the place where the offeror is informed that the offeree has accepted the offer.¹²¹⁶ But the information theory will not apply in all instances. The offeror may specify a manner of acceptance that makes it unnecessary to inform him or her.¹²¹⁷ In terms of the expedition theory, a contract in which the offer was posted will come into existence at the place where the letter of acceptance was posted.¹²¹⁸ The expedition theory will apply only if the offer was made via the post and not if it was made between parties present (*inter praesentes*).¹²¹⁹ It should be noted that in the case of contracts concluded by telephone, the parties are considered to be in each other's presence and thus the contract will come into being when and where the offeree's acceptance is communicated to and received by the offeror.¹²²⁰ Of course, parties may specify in their agreement where a contract will come into being and then the theories mentioned above will not apply.

¹²¹⁴ See ch 2.2.2. Muller argues that the date on which the trust administration commences is the relevant date to determine whether a trust has been established or formed. Her argument is based on the definition of "trust" in the Income Tax Act which provides that a trust is "any trust fund consisting of cash or other assets which are *administered and controlled by a person acting in a fiduciary capacity*, where such person is appointed under a deed of trust or by agreement or under the will of a deceased person" (own emphasis). She submits that this definition "looks to the moment when the trust administration has commenced, as opposed to when it is created". She refers to authority that distinguishes between *essentialia* for the creation of a valid trust and *essentialia* at the commencement of the administration of the trust. The latter requires a duly appointed trustee and the transfer of ownership or control of the trust property to the trustee. She argues that it is only once these *essentialia* are met that a trust is established or formed (Muller *Determining the Residence of a Trust: a South African Income Tax Perspective* 167). It is submitted that this argument cannot be supported. The time of formation of an entity (the trust, in this case) is regulated by the relevant law governing that entity (trust law in this case), not the Income Tax Act. The fact that a trust, duly formed in terms of trust law, qualifies as a "trust" for purposes of the Income Tax Act, does not alter this. If the legislature wished to amend the time of establishment or formation of a trust in the Income Tax Act from that established by trust law, it would have done so in more explicit terms.

¹²¹⁵ Du Toit *South African Trust Law: Principles and Practice* 37; Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 315.

¹²¹⁶ Van der Merwe *et al Contract: General Principles* 55; Christie *The Law of Contract in South Africa* 68. See also Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 338.

¹²¹⁷ Van der Merwe *et al Contract: General Principles* 68; Christie *The Law of Contract in South Africa* 68.

¹²¹⁸ Van der Merwe *et al Contract: General Principles* 69; Christie *The Law of Contract in South Africa* 72.

¹²¹⁹ Van der Merwe *et al Contract: General Principles* 71; Christie *The Law of Contract in South Africa* 73.

¹²²⁰ *Jamieson v Sabingo* 2002 4 SA 49 (SCA) 54. The court also stated that contracts concluded by way of telefax and telex are contracts where the parties are considered to be in each other's presence. This part of the court's judgement has been criticised (Van Der Merwe *Information and Communications Technology Law* 150). More importantly, though, telexes and telefaxes are considered to be "data messages" as defined in s 1 of the Electronic Communications and Transactions Act 25 of 2002 and the time and place of their conclusion are therefore now governed by that Act, making the *Jamieson* case irrelevant in relation to telexes and telefaxes (Van Der Merwe *Information and Communications Technology Law* 150).

Regarding electronic transactions, the Electronic Communications and Transactions Act (ECTA)¹²²¹ provides that, in the absence of contrary arrangements in the agreement, an agreement concluded by means of data messages¹²²² is concluded at the time and place where the acceptance of the offer was received by the offeror.¹²²³ A data message is regarded as having been received by the addressee when the complete data message enters an information system designated or used for that purpose by the addressee and is capable of being retrieved by the addressee.¹²²⁴ The data message is regarded as having been received at the addressee's usual place of business or residence.¹²²⁵ Thus, as stated in *Jafta v Ezimvelo KZN Wildlife*, "... section 23 supplants the general rule of the common law that an acceptance of an offer must come to the knowledge of the offeree for a contract to arise".¹²²⁶

The default rule laid down in ECTA regarding the place of formation of the contract is problematic. Although no attempt will be made to suggest any real solutions, some of the difficulties with the default rule are briefly mentioned here. It is unclear whether the phrase "usual place of ..." qualifies only the word "business" or whether it also qualifies the word "residence". Clearly, "residence" and "usual place of residence" could potentially be interpreted differently. The two places of receipt – "usual place of business" and "residence" – seem to be alternatives and this invites the question of which one will prevail if they are not in the same place. One possible interpretation could be to apply the criterion of "residence" to individuals and "usual place of business" to businesses, but ECTA gives no indication that this was the legislature's intention. Nor does ECTA define the terms "usual place of business" or "residence". The definition of "resident" in the Income Tax Act¹²²⁷

¹²²¹ Electronic Communications and Transactions Act 25 of 2002. This Act does not authorise the execution of wills in electronic format and is therefore not relevant to testamentary trusts (Electronic Communications and Transactions Act 25 of 2002 s 4, read with Schedule 2; Muller *Determining the Residence of a Trust: a South African Income Tax Perspective* 182).

¹²²² A "data message" is defined in s 1 of ECTA as "data generated, sent, received or stored by electronic means". An e-mail is an example of a "data message" as defined (Electronic Communications and Transactions Act 25 of 2002 s 1 definition of "e-mail"). A data message would, however, not include electronic communications if the parties are "to all intents and purposes in each other's presence", to use a phrase quoted in *Jamieson v Sabingo* 2002 4 SA 49 (SCA). An example of communication that uses the internet, but that would not be a "data message" as defined, is the conclusion of an oral contract by way of "Skype". The rules set out above for parties who are *inter praesentes* would apply to contracts concluded by these means (Van Der Merwe *Information and Communications Technology Law* 148).

¹²²³ Electronic Communications and Transactions Act 25 of 2002 s 22. It is submitted that the conclusion of a trust deed is not an "automated transaction" (defined as "an electronic transaction conducted or performed, in whole or in part, by means of data messages in which the conduct or data messages of one or both parties are not reviewed by a natural person in the ordinary course of such natural person's business or employment" (Electronic Communications and Transactions Act 25 of 2002 s 1)), and that the provisions regarding automated transactions contained in ECTA are not applicable to trust deeds.

¹²²⁴ Electronic Communications and Transactions Act 25 of 2002 s 23(b). Both these requirements must be met (*Jafta v Ezimvelo KZN Wildlife* 2008 10 BLLR 954 (LC) para 90).

¹²²⁵ Electronic Communications and Transactions Act 25 of 2002 s 23(c).

¹²²⁶ *Jafta v Ezimvelo KZN Wildlife* 2008 10 BLLR 954 (LC) para 80. This case also confirmed that an SMS will be regarded as "electronic communication" and therefore be governed by ECTA (para 112). Furthermore, the court held that s 23 of ECTA does not create a presumption or a deeming provision. Thus, a lower standard of proof is required of an addressee who denies receipt. The court found that what will constitute sufficient evidence to shift its evidential burden depends on the circumstances of each case, taking into account the overarching objectives of ECTA (para 88).

¹²²⁷ Income Tax Act 58 of 1962.

cannot simply be read into ECTA. In interpreting the word “residence” in ECTA, the dictum of Galgut J in *Tick v Broude*¹²²⁸ should be borne in mind:

“[T]he word ‘residence’ has not acquired any technical meaning and is used in law with many shades of meaning ranging from mere physical presence to domicile ... All the above cases show that ‘residence’ is a word which varies in meaning according to the circumstances under which it is used. In most cases it will be a question of degree.”

The term “usual place of business” should also be interpreted in accordance with the purposes of ECTA. In the light of these uncertainties, it is submitted that parties should consider stipulating in a trust instrument that is sent electronically exactly where the agreement will be concluded.¹²²⁹

If the above theories and legislation are applied to the law of trusts, then under the information theory an *inter vivos* trust is created where the settlor (usually the offeror) is informed of acceptance by the trustee (the offeree). Accordingly, if the information theory applies to a trust deed, the trust will be “formed” or “established” in South Africa only if the settlor (as offeror) is present in South Africa when informed of acceptance by the trustee. If the expedition theory is applied, a trust will only be “formed” or “established” in South Africa if the trustee posts¹²³⁰ the trust deed in South Africa. If there is more than one trustee, it is submitted that the intention of the parties must be examined. If it is their intention (as it usually would be) that all the trustees must accept the offer before a valid trust would be created, it would mean that in a case in which the information theory were applied, the trust will come into existence at the time when and place where the settlor is present when informed that the last trustee has accepted the offer. An example illustrates the point: a settlor wishes to form a trust of which A, B and C are to be trustees. A and B sign the trust deed, and the founder is present in South Africa when notified of their signature, but is outside South Africa when informed of C’s acceptance. In that event, the trust will not be resident in South Africa. In this example, the place where the trustees accept is irrelevant, because the information theory applies.

In the case where the trust deed signed by the trustees is posted and the expedition theory applies, it is submitted that the trust will be formed at the place where the last trustee accepts the offer by posting the signed trust deed to the founder. On the same facts in the above example, the trust would be formed at the place where C posts the trust deed, irrespective of the place where A or B posts the trust deed. If the expedition theory is

¹²²⁸ *Tick v Broude* 1973 1 SA 462 (T) 469.

¹²²⁹ It should be noted that the Electronic Communications and Transactions Amendment Bill (draft) in GN 888 of 2012 GG 35821 of 26-10-2012 was published in 2012. This Bill proposes an amendment to the definition of “data message”, so that it will now read as follows: “electronic communications including (a) voice, where the voice is used in an automated transaction; and (b) any other form of electronic communications stored as a record”. Furthermore a new definition of “e-mail” is proposed, namely “electronic mail such as a data message used or intended to be used as a form of correspondence between the originator and addressee”. Moreover, s 23(c) will be amended to read as follows: “regardless of the device, will be regarded as having been sent from the originator’s usual place of business or residence and as having been received at the addressee’s usual place of business or residence”. It is submitted that none of these proposed amendments affect the conclusions reached above.

¹²³⁰ The word “post” is used in the conventional sense: to use the official system by which letters are carried and delivered.

applied, the place where the founder is present at the time of signature by any of the parties is irrelevant.¹²³¹ In the case of a trust instrument sent via e-mail,¹²³² and if it is assumed that the parties have not made an alternative arrangement, the trust will be formed in South Africa if the settlor (offeror) is resident or has his or her usual place of business in South Africa, whatever the expressions “usual place of business” or “residence” may mean.

As regards a testamentary trust, it is submitted that the trust is formed at the place where the testator executes the will through which the trust is formed.¹²³³ Although the testamentary trust is formed only on the death of the testator, the will is the instrument through which the trust is formed and the place of its execution is therefore the pertinent place. It should be noted the execution of a will means compliance with all the formalities required for a valid will.¹²³⁴ Hence it is only once all the formalities have been complied with that a will is executed.¹²³⁵ For example, a will signed by a testator is executed only once the witnesses have also signed it. If a testator who signed a will in South Africa with no witnesses present then travels to another country and acknowledges his or her signature in front of two competent witnesses in that country, he or she executes his or her will in that other country, not in South Africa. It is submitted that a trust formed in such a will is not formed in South Africa. The place where the testator dies is irrelevant.

Since a trust is not “established” or “formed” through the registration of the trust instrument, or the authorisation of the trustees by the Master,¹²³⁶ these formal acts by the

¹²³¹ In a case where the settlor is also a trustee, it is submitted that the same principles set out in this paragraph will apply.

¹²³² Or via SMS.

¹²³³ Oliver and Honiball state that a testamentary trust is resident in South Africa if the will in terms of which it was created was “drawn up” in South Africa (Olivier and Honiball *International Tax: a South African Perspective* 153). Oguttu agrees with this view (Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 338). Muller criticises the view that trusts are formed at the place where the will is executed on three grounds: (a) It may result in trusts being regarded as resident in South Africa although they only have a “formal or superficial connection of signatures affixed to the trust instrument, but has no substantive connection in that the Will may not necessarily be lodged with such countries’ authorities nor may the trust be recognised under its laws”; (b) The country where the will was executed may not be aware of its existence; (c) There is no requirement that the date and place where a will was executed, be recorded in the will. Although such a recordal is usually included in practice, a will not containing such a recordal will still be valid and evidence will have to be led to show its place of execution, which may cause a protracted enquiry. She concedes, however, that despite the impracticalities and on a “strict literal interpretation of the relevant law”, it is correct in law that the place where a testamentary trust is formed, is where the will is executed. She submits that a trust should be regarded as formed at the place where it is subject to public authority, but acknowledges that this is a practical proposal, which is not supported by the relevant legal framework (Muller *Determining the Residence of a Trust: a South African Income Tax Perspective* 171–179). Muller’s criticism is based on practical grounds, but it is submitted that a legislative amendment would be required to accommodate her proposal. Such an amendment is recommended in this paragraph. However, as the law stands currently, her proposal cannot be supported.

¹²³⁴ *In re Jennett* 1976 1 SA 580 (A) 584.

¹²³⁵ The Wills Act 7 of 1953 s 2(3) provides that a court shall order the Master to accept a document that does not comply with all the formalities for the execution of a will if the court is satisfied that the document drafted or executed by a person who has died since the drafting or execution thereof, was intended to be that person’s will. There may be cases where a document, which does not comply with all the formalities for execution, makes provision for a testamentary trust and is accepted by the courts as a will in terms of the above-mentioned provision. It is submitted that in such a case, the trust will be formed where the document was drafted or executed by the deceased.

¹²³⁶ See ch 2.2.5.

Master are irrelevant in determining a trust's residence.¹²³⁷ In the *Oceanic Trust*¹²³⁸ case, the South African Revenue Service (SARS) initially relied on the fact that the particular trust (the residence of which was in issue) was registered with the Master of the High Court, who issued authority to the trustee to act as such, to show that the trust was established in South Africa. However, this ground was abandoned and it is submitted that one can deduce from its conduct in this case that SARS also does not view these facts as determining the trust's place of formation or establishment.

It seems that if the rules on the formation of trusts are applied in order to determine their residence, the place of "formation" or "establishment" may be either arbitrary or easily manipulated.

One possible solution to this problem could be to amend the Income Tax Act to provide that a trust will be resident in South Africa if registration of the trust instrument and authorisation of trustees are required in terms of the Trust Property Control Act.¹²³⁹ However, this solution would not apply to oral trusts which are not covered by that Act.¹²⁴⁰ In the absence of such an amendment, the second criterion to determine residence, POEM, will be very important.

6.3.1.3 POEM¹²⁴¹

As mentioned above, a trust will be resident in South Africa if it has its POEM in South Africa (and provided that it is not deemed to be exclusively a resident of another country for purposes of a DTT). The two central questions that must be answered are therefore what the meaning of POEM is and how the term POEM is to be applied to trusts.¹²⁴²

6.3.1.3.1 The meaning of POEM in the Income Tax Act and DTTs

Regarding the meaning of the term POEM, it should be noted that it is not defined in the Income Tax Act. The question has been raised whether the term POEM used in the Income Tax Act should be given the same or a different meaning as the term POEM used in article 4(3) of the OECD MTC.

The Katz Commission, which first proposed the introduction of the term POEM into the Income Tax Act, seemed to suggest that the meaning should be the same.¹²⁴³ Van der Merwe argues that the term bears the same meaning in both the Income Tax Act and article

¹²³⁷ For a contrary view see Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 314.

¹²³⁸ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127.

¹²³⁹ Trust Property Control Act 57 of 1988.

¹²⁴⁰ See ch 2.2.5.

¹²⁴¹ The acronym POEM is used for the term "place of effective management". Strictly speaking POEM is not a term, but a phrase or a concept. However, the word "term" was used in other parts of this dissertation (eg ch 5) in relation to other words in the OECD MTC and, for the sake of consistency and convenience, this is continued in relation to POEM.

¹²⁴² The latter question will be addressed in ch 6.4.4.

¹²⁴³ Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa *5th Interim Report of the Commission of Inquiry into certain Aspects of the Tax Structure of South Africa - basing the South African Income Tax System on the Source or Residence Principle - Options and Recommendations* para 6.1.2.1; Olivier and Honiball *International Tax: a South African Perspective* 27.

4(3), based on the fact that treaties entered into by South Africa form part of the Income Tax Act in terms of section 108(2).¹²⁴⁴ Van der Merwe also argues that the Income Tax Act has adopted the same purpose as article 4(3), namely to determine a single residence.¹²⁴⁵ De Koker and Williams also take the view that the term bears the same meaning in both the Act and in DTTs.¹²⁴⁶ Olivier and Honiball imply that the term does not have the same meaning for purposes of the Income Tax Act and for treaty purposes, based on the influence of SARS's Interpretation Note.¹²⁴⁷ A similar view is expressed in Juta's Commentary on Income Tax.¹²⁴⁸ Hattingh tentatively suggests that South African courts may attach a different meaning to the term for purposes of the Income Tax Act and for treaty purposes. This view is based on the opinion that South African courts will interpret legislation based on its function and the context. The function and context differ under the Income Tax Act and a DTT in relation to POEM in that in the Income Tax Act it serves as one of two connecting factors to establish residence. Under a DTT POEM "...serves to resolve double taxation by providing comprehensive taxing rights on a worldwide income to only one contracting State to a tax treaty and limited source taxing rights to the other country party to that tax treaty".¹²⁴⁹

In *Oceanic Trust*¹²⁵⁰ the court did not discuss the question whether the meaning of the term POEM in the Income Tax Act, with which it was confronted, was the same as the meaning of the term under a DTT. However, the court did adopt the test laid down in the United Kingdom case of *Smallwood* in relation to POEM, a case which dealt with the meaning of POEM in a treaty context.¹²⁵¹ Arguably, one could deduce that the court, by implication, indicated that the same meaning should apply in the Income Tax Act as in a DTT. The court in *Tradehold* did not discuss this question either.

The Constitution provides that when interpreting any legislation, every court must prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law.¹²⁵² It was argued earlier in this dissertation that there is no obligation on South African courts to interpret the Income Tax Act in a way that is consistent with the OECD MTC and its Commentary, since neither of these are international law instruments.¹²⁵³ The DTTs entered into by South Africa are, however, a source of international law¹²⁵⁴ and as such an interpretation of the Income Tax Act that is consistent with South Africa's DTTs should be preferred. Since the term POEM is used in most of South Africa's DTTs,¹²⁵⁵ it is submitted that the term POEM in the Income Tax Act should be interpreted in a way that is consistent with the term POEM used in South Africa's DTTs. This argument is supported by the fact that a DTT forms part of the Income

¹²⁴⁴ Van der Merwe (2002) 14 *Residence of a Company - the Meaning of 'Effective Management'* 79 79.

¹²⁴⁵ Van der Merwe (2002) 14 *Residence of a Company - the Meaning of 'Effective Management'* 79 88.

¹²⁴⁶ De Koker and Williams *Silke on South African Income Tax* para 14.42.

¹²⁴⁷ Olivier and Honiball *International Tax: a South African Perspective* 42.

¹²⁴⁸ Davis *et al* *Juta's Commentary on Income Tax* Commentary on s 1 definition of resident.

¹²⁴⁹ Hattingh in *Residence of Companies under Tax Treaties and EC Tax Law* 725.

¹²⁵⁰ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127.

¹²⁵¹ Gutuza (2012) 24 *SA Merc LJ* 424 426, who also avers that the court in *Oceanic* relied on the OECD Commentary on art 4(3) of the OECD MTC.

¹²⁵² Constitution of the Republic of South Africa s 233.

¹²⁵³ See ch 4.3.2.1.

¹²⁵⁴ See ch 4.4.1.

¹²⁵⁵ Hattingh in *Residence of Companies under Tax Treaties and EC Tax Law* 721.

Tax Act.¹²⁵⁶ Thus the term POEM should be given the same meaning in the Income Tax Act as it is given under South Africa's DTTs.

It is furthermore submitted that although the context differs, the aim of the term POEM under DTTs and the Income Tax Act is the same. The aim in the DTT context is to "determine 'best residency' from a choice of at least two residencies".¹²⁵⁷ However, as argued by Van der Merwe, the aim of the Income Tax Act is also to determine a single residence for an entity.¹²⁵⁸ Van der Merwe's argument may find support in the decision in *Oceanic Trust* where the court, in interpreting the meaning of POEM in the Income Tax Act, adopted the "Smallwood test", which included a statement that there can only be one POEM at any one time.¹²⁵⁹

6.3.1.3.2 SARS's view regarding the meaning of POEM

Different views have been expressed in South Africa regarding the meaning of POEM. SARS has issued an Interpretation Note in 2002 to explain its views on the meaning of the term.¹²⁶⁰ This note states that "effective management" is not the same as shareholder control¹²⁶¹ or control by the board of directors. The note sets out SARS's general approach as follows:

"The place of effective management is the place where the company is managed on a regular or day-to-day basis by the directors or senior managers of the company, irrespective of where the overriding control is exercised, or where the board of directors meets.

Management by these directors or senior managers refer to the execution and implementation of policy and strategy decisions made by the board of directors. It can also be referred to as the place of implementation of the entity's overall group vision and objectives.

Management structures, reporting lines and responsibilities vary from entity to entity, depending on the requirements of the entity, and not hard and fast rules exist. It is therefore not possible to lay down absolute guidelines in this regard."

The Interpretation Note also contains a paragraph dealing with the practical application of SARS's view. This paragraph, read with the one quoted above, reinforces the view that SARS considers the POEM to be the place where management decisions are implemented. The

¹²⁵⁶ See ch 4.4.1.

¹²⁵⁷ Gutuza (2012) 24 SA Merc LJ 424 426.

¹²⁵⁸ Van der Merwe (2002) 14 *Residence of a Company - the Meaning of 'Effective Management'* 79 88.

¹²⁵⁹ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127 para 54. As mentioned earlier, *Smallwood* dealt with the meaning of POEM in a treaty context, where the aim is to determine a single residence for purposes of the application of the treaty. The court in *Oceanic Trust* did not make a distinction between the treaty context and the context of the Income Tax Act.

¹²⁶⁰ South African Revenue Service *Resident: Place of Effective Management (Persons other than Natural Persons)*. It is axiomatic that SARS's Interpretation Notes are not law (Olivier and Honiball *International Tax: a South African Perspective* 42; Hattingh in *Residence of Companies under Tax Treaties and EC Tax Law* 685). Therefore, neither the courts nor taxpayers are bound to Interpretation Notes.

¹²⁶¹ But see Gutuza (2012) 24 SA Merc LJ 424 who argues that shareholder control of a company may be relevant to determine POEM.

place where decisions are made (as opposed to implemented) is therefore irrelevant. Also, it is clear that SARS does not view the overall and top level of management as “effective management”. Rather, according to SARS, it is a lower level of management that is the effective management. SARS’s view on the meaning of the term POEM has been both criticised and praised.¹²⁶² One point that should be noted regarding this Interpretation Note is that the drafters clearly had companies and not other entities such as trusts in mind when drafting the note.

In September 2011, SARS issued a Discussion Paper¹²⁶³ regarding the term POEM. Its intention was to invite comments from taxpayers and practitioners regarding their concerns on the meaning of POEM and to provide a framework for discussion of possible revisions to the Interpretation Note. According to SARS certain practitioners were concerned that foreign operating subsidiaries of South African headquarter companies would be regarded as being effectively managed in South Africa, thereby negating the benefits of the headquarter company regime.

The Discussion Paper makes it clear that it is limited to “issues involving domestic and foreign companies” and continues that “[l]egal persons other than companies, such as ... trusts, present separate and distinct issues and will be addressed in a subsequent project”.¹²⁶⁴ Its statement that a trust is a legal person is clearly wrong in law¹²⁶⁵ and it is hoped that this error will be corrected in the “subsequent project”. Despite its seemingly limited intention (in relation to the headquarter company regime) and incorrect statement, it is submitted that the Discussion Paper is still a useful indication of SARS’s views on the meaning of POEM and it is therefore discussed in more detail.

The Discussion Paper gives a brief description of SARS’s current interpretation of POEM as set out in Interpretation Note 6. It then summarises some of the criticism¹²⁶⁶ that has been levelled against this Note. The main point of criticism has been that the Interpretation Note has focused on implementation and execution of decisions, rather than the place where those decisions were being taken.¹²⁶⁷ Turning to the use of the term POEM internationally, the Discussion Paper draws a distinction between the “board-centric approach” (meaning that the decision-making by the company’s board or similar structure is the key factor) and the “continental approach” (meaning that importance is placed on the place where senior management operates). The Discussion Paper continues to consider the criticism against the board-centric approach noting that it “has failed to keep pace with changes in

¹²⁶²Eg Oguttu (2008) 41 *Comparative and International LJ* 80 99 and 103.

¹²⁶³ South African Revenue Service *Discussion Paper on Interpretation Note 6: Place of Effective Management*.

¹²⁶⁴ South African Revenue Service *Discussion Paper on Interpretation Note 6: Place of Effective Management* para 2.

¹²⁶⁵ See ch 2.2.4.

¹²⁶⁶ For criticism of the Interpretation Note see eg Van der Merwe (2006) 18 *The Phrase 'Place of Effective Management' Effectively Explained?* 121; Hattingh in *Residence of Companies under Tax Treaties and EC Tax Law* 689.

¹²⁶⁷ Other points of criticism noted in the Discussion Paper are the inconsistent use of terminology, that some of the factors listed in the Interpretation Note to determine a company’s POEM are inconsistent with the Note’s general approach and the failure to provide guidance in the case of passive or intermediate holding companies (South African Revenue Service *Discussion Paper on Interpretation Note 6: Place of Effective Management* para 6).

telecommunications, international travel and modern business practices”.¹²⁶⁸ It also discussed the OECD’s response to these changes, mentioning that in 2008 the OECD amended its commentary dealing with POEM to omit any reference to the board of directors.¹²⁶⁹ After a discussion of two United Kingdom cases,¹²⁷⁰ the Discussion Paper makes certain tentative proposals. Its first proposal is that the general approach of Interpretation Note 6 should be retained, but that this approach should be refined. More specifically, the Discussion Paper explains that the “second level” of management, that is, “those ‘top’ personnel who ‘call the shots’ and exercise ‘realistic positive management’”, will be regarded as effectively managing the company. The Discussion Paper continues as follows:

“In general, these individuals would be the senior officers or executives who are responsible for: (1) actually developing or formulating key operational or commercial strategies and policies for, or taking decisions on key operational or commercial actions by the company (regardless of whether those strategies, policies and decisions are subject to formal approval by a board or similar body) and (2) ensuring that those strategies and policies are carried out. Areas of decision-making involving extraordinary matters (such as major acquisitions, disposals, mergers or new borrowing) that are commonly reserved to a company’s board or its shareholders generally would not be considered part of this ‘second level of management’ for a foreign operating subsidiary and therefore generally would not affect the determination of a foreign operating subsidiary’s place of effective management. Similarly, day-to-day operational decision-making by junior and middle management would also generally fall outside of the second level of management, as would the performance of routine administrative or support functions.”¹²⁷¹

The Discussion Paper further proposes that references in Interpretation Note 6 to “implementation” of decisions be omitted. The implication of this omission will be that the place where decisions are taken (as opposed to being implemented) will be relevant. The Discussion Paper also correctly emphasises that no definitive rules can be laid down and that the facts and circumstances of each case must be considered to determine the POEM of a company.¹²⁷² Further proposals include the definition of certain terms and amendments to the list of facts and circumstances contained in the Interpretation Note which are used to determine a company’s POEM.¹²⁷³

¹²⁶⁸ South African Revenue Service *Discussion Paper on Interpretation Note 6: Place of Effective Management* para 7.1.

¹²⁶⁹ South African Revenue Service *Discussion Paper on Interpretation Note 6: Place of Effective Management* para 7.2.

¹²⁷⁰ South African Revenue Service *Discussion Paper on Interpretation Note 6: Place of Effective Management* para 7.3 discusses *Commissioners for Her Majesty’s Revenue and Customs v Smallwood* [2010] EWCA Civ 778 and *Laerstate BV v HMRC* [2009] UKFIT 209 (TC). Both cases are discussed in a later paragraph (chs 6.3.2.2 and 6.4.3.2).

¹²⁷¹ South African Revenue Service *Discussion Paper on Interpretation Note 6: Place of Effective Management* para 8.1.

¹²⁷² South African Revenue Service *Discussion Paper on Interpretation Note 6: Place of Effective Management* para 8.1.

¹²⁷³ South African Revenue Service *Discussion Paper on Interpretation Note 6: Place of Effective Management* paras 8.2 and 8.3.

Since the publication of the Discussion Paper, SARS has not issued any further publications specifically dealing with POEM and neither have they withdrawn the Interpretation Note. However, the Income Tax Act has been amended subsequent to the Discussion Paper, but none of SARS's proposals were implemented through an amendment of the Income Tax Act.

6.3.1.3.3 Case law and academic views regarding the meaning of POEM

Since the publication of the Discussion Paper, the Supreme Court of Appeal has pronounced on the meaning of POEM in the *Tradehold*¹²⁷⁴ case. In that case the taxpayer, Tradehold, was an investment holding company incorporated in South Africa. Tradehold had only one asset, namely 100 per cent of the shares in Tradegro Holdings which, in turn, held 100 per cent of the shares in Tradegro Limited, a company incorporated in Guernsey, which owned approximately 65 per cent of the shares in a United Kingdom-based company. Tradehold's board resolved at a meeting in Luxembourg that all future board meetings would take place in Luxembourg. The court held that "[t]his had the effect that, as from [the date of the board meeting], Tradehold became effectively managed in Luxembourg".¹²⁷⁵

Effectively the court held that the decision by Tradehold's board (that all future board meetings would be held in Luxembourg) and possibly their further board meetings, constituted the effective management of Tradehold. The court therefore held that in this case effective management took place at the highest level of management, namely the board of directors, and that it is the place of decision-making (and not its implementation) that is relevant. However, it is submitted that it would be an oversimplification of the court's decision if it were to be deduced that decision-making at board level will always equal effective management.¹²⁷⁶ In this regard it should be borne in mind that Tradehold was an investment holding company and that its only asset was its shareholding in its wholly-owned subsidiary. The management activities of this company would certainly be very different from the management activities undertaken in an operating company. It is unlikely that an investment holding company with only one asset would have any other level of management than a board of directors. The board's activities would presumably be limited to decisions regarding transactions involving the shares or (possibly) the acquisition of new assets. It is therefore not surprising that the court in *Tradehold* held that its POEM was the place where its board made its decisions. In other circumstances, a court may arguably come to a different conclusion, although the decision in *Tradehold* would have to be carefully distinguished, bearing in mind that it was a decision by the Supreme Court of Appeal.

¹²⁷⁴ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA). This case was discussed earlier in this dissertation in relation to other topics (see ch 4.3.2.2. and ch 5.2.6.). The discussion of the case in this paragraph focuses only on the aspects relating to POEM.

¹²⁷⁵ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 3.

¹²⁷⁶ Classen (2013) 25 SA Merc LJ 387 394 seems to agree with this conclusion, but for different reasons. She also argues that the *Tradehold* case was very fact specific and did not influence the interpretation of the POEM concept "because the application of this test to the facts of this matter was not attempted by the parties before court". It is not clear what the author means when she says that the matter was not "attempted by the parties before court", but it is nevertheless submitted that it cannot be accepted that *Tradehold* did not influence the interpretation of POEM. The court had all the facts that it required to make a decision regarding POEM in front of it and on that basis pronounced on the meaning of POEM. It is submitted that the decision is no more fact specific than any other and may be applied, subject to the argument set out in the main text, to other cases. Although a fuller discussion of the point by the Supreme Court of Appeal would have been welcome, the decision cannot be dismissed because of the lack of such a discussion.

A further case to be borne in mind when discussing the POEM of a trust is *Oceanic Trust*.¹²⁷⁷ The facts in that case are that SIMS was a trust that was established and registered in Mauritius. Its sole trustee was the Oceanic Trust Co Ltd, a company registered and incorporated in Mauritius. In terms of the trust deed, the law of Mauritius was to govern the administration of the settlement and trustees were obliged to maintain their principal place of business at, and conduct their affairs from, premises in Mauritius. SIMS acted as captive reinsurer to MCubed Life Ltd, a South African registered company (and, it is assumed, also a South African resident for tax purposes).

SARS issued an assessment against SIMS averring, *inter alia*, that SIMS was a resident of South Africa. SIMS had lodged an objection against the assessment. But before this matter was heard by the relevant court, SIMS, through its trustee, the Oceanic Trust Co Ltd, approached the court for a declarator. It asked the court, *inter alia*, to find that it was not a resident. The basis of Oceanic Trust Co Ltd's application was that SARS accused it of failing to provide it with certain information. In terms of the Income Tax Act,¹²⁷⁸ only "taxpayers" are required to provide information to SARS. Whether SIMS was a taxpayer and therefore obliged to provide the information to SARS, turned on whether it was a resident and, more specifically, whether it had its POEM in South Africa. The court was therefore not asked to decide the merits of the appeal against the assessment, but merely to rule on whether or not SIMS had its POEM in South Africa.

In order to qualify for the declaratory order, SIMS, through its trustee, had to show that only questions of law (and not questions of fact) had to be decided by the court. SARS contended that this application involved both questions of law and questions of fact and that the court therefore could not issue the declaratory order. Much of the judgement dealt with the issue of whether there were only questions of law, or also questions of fact, to be decided. In the end, the court sided with SARS. The effect was that the court could not grant the relief prayed for by SIMS's trustee.

However, the court continued (in what is submitted to be an *obiter* finding¹²⁷⁹) to state that it had not been established that SIMS's POEM was outside South Africa. In deciding the meaning of the term POEM, the court applied the test laid down by the Special Commissioners in the United Kingdom case of *Smallwood*.¹²⁸⁰ This test, the court found, was

¹²⁷⁷ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127. This case was referred to briefly earlier in this dissertation (see ch 4.3.2.2.), but is discussed in greater detail here.

¹²⁷⁸ Income Tax Act 58 of 1962 s 74.

¹²⁷⁹ Classen (2013) 25 *SA Merc LJ* 387 395 shares the view that the finding is *obiter*. However, she continues to state that POEM was not applied to the facts in the case. It is submitted that this statement is not correct. The court stated that "[t]herefore, applying the *Smallwood* test, the facts to the extent that they have been established, do not, in my view, establish that the POEM of SIMS was in Mauritius, and not in South Africa (*The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127 para 58). It is clear from this statement that the court did apply POEM (as interpreted in the *Smallwood* case) to the facts, to the extent that the facts were established.

¹²⁸⁰ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778. This case is discussed in greater detail in chs 6.3.2.2 and 6.4.4. It is unclear why the court referred only to the decision by the Special Commissioners and not the decision by the Court of Appeal (the Chancery Division deciding the case on a different point, making the consideration of POEM unnecessary). The decision of the Special Commissioners was delivered in 2008 and the Court of Appeal's decision in June 2010. The decision in *Oceanic Trust* was handed down almost a year later in June 2011.

as follows.¹²⁸¹ The POEM is the place where key *management* and *commercial decisions* that are necessary for the conduct of the entities business are in substance made. The POEM will *ordinarily* be the place where the most senior group of persons (for example, a board of directors) makes its decision, where *the actions to be taken* by the entity as a whole are determined. However, no definite rule can be given and all relevant facts and circumstances must be examined to determine the POEM of an entity. There may be more than one place of management, but only one POEM at any one time. The court added that the decision in *Smallwood* was not based only on this test, but also on a specific provision in the United Kingdom legislation. The court also highlighted that the court in the *Smallwood* case analysed the facts and the scheme in great detail before deciding on the issue of POEM.

On the facts before it, the court held that at least some of the key management decisions and at the very least some of the key commercial decisions necessary for the conduct of SIMS's business were in substance made in South Africa.¹²⁸² Hence, the court held that it had not been established that SIMS's POEM was in Mauritius. Presumably, the court's finding in this regard was based on the following facts, which the Oceanic Trust Co Ltd conceded may be relied on to decide the matter. SIMS derived all its business from MCubed Life Ltd. SIMS was required to invest all the reinsurance premiums in assets to be held in South Africa and it also appointed a South African asset manager to manage these assets. The asset manager was a wholly-owned subsidiary of MCubed Holdings Ltd and MCubed Holdings Ltd was also the only shareholder in MCubed Life Ltd. MCubed Holdings Ltd and its operating division frequently gave instructions to the asset manager on the SIMS investments. SIMS held a bank account in South Africa and never transferred any money to and from Mauritius. SIMS's entire income was generated from business activities actually conducted in South Africa.

A significant aspect of this case is the court's adoption of the test laid down in *Smallwood* regarding the meaning of POEM. The court did not mention SARS's (different) view regarding POEM, or any of the OECD material regarding the meaning of POEM in DTTs. However, by adopting the *Smallwood* test, the court effectively adopted the meaning of POEM as expressed in the OECD commentary to article 4 of the OECD MTC (albeit prior to its amendment in 2008). It could therefore be argued that the South African domestic tax law meaning of POEM is the same as that expressed by the OECD in its commentary to article 4 (prior to its amendment).

One puzzling aspect of the case is the way that it dealt with the definition of residence. The taxpayer was assessed for the 2000 to 2007 years of assessment. The definition of "resident" was amended, with effect from 26 February 2003, to include an exception, namely that "any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the government of the Republic of South Africa and that other country for the avoidance of double taxation, would not be a resident".¹²⁸³ Therefore, at least from the 2004 tax year onwards, as long as the taxpayer could show that it was a resident of Mauritius for purposes of the DTT, it could not be regarded as a resident in South Africa.

¹²⁸¹ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127 para 54.

¹²⁸² This point will be returned to later in this chapter (see ch 6.4.4.).

¹²⁸³ Income Tax Act 58 of 1962 s 1 definition of resident, amended by Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003 s 33.

The court quoted the definition contained in the relevant DTT, which reads as follows:

“For the purposes of this agreement:

- (a) The term ‘resident of Mauritius’ means any person who, under the laws of that state, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature. This term does not include any person who is liable to tax in Mauritius in respect only of income from sources in Mauritius; and
- (b) The term ‘resident of South Africa’ means any individual who is ordinary resident in South Africa and any legal person which *has its place of management in South Africa.*” (emphasis added by Court)

What is immediately apparent from the definition of resident of South Africa is that only individuals and juristic persons are dealt with. In terms of South African law, a trust is neither an individual, nor a juristic person,¹²⁸⁴ and one could therefore argue that a trust is not a resident of South Africa for purposes of the DTT. If this argument were to succeed, it would not be necessary to apply the tiebreaker provision in the relevant DTT, as the trust would not be a dual resident. It would only be a resident of Mauritius, which would mean that, from 2004 onwards, the trust would not be regarded as a resident of South Africa for South African domestic law purposes. However, the argument could possibly fail if trusts are regarded as juristic persons in terms of Mauritian trust law.

Academic authors have given differing views on the meaning of POEM. Most of these views were expressed before the decisions in *Oceanic Trust* and *Tradehold* were handed down and are therefore not discussed in detail.¹²⁸⁵ Some of these authors prefer a view similar to that of SARS (that is, that day-to-day management is to be regarded as effective management) whilst others prefer a meaning that focuses on the highest level of decision-making. According to Gutuza the views illustrate two possible approaches, the one focusing on the “directing mind” of the company and the other focussing on company rules as set out in its documents and in the law. Gutuza further states:

“The first approach would attribute certain ‘human’ characteristics to the company by seeking to find the ‘mind’ which effectively manages it. This mind is located in some individual or body of persons. The second approach would scrutinise the company’s founding documents, and the relevant law (both case law and legislation) to determine which person or body is empowered to ‘effectively manage’ the company in terms of its rules. The first approach can also be referred to ‘*de facto* place of effective management’, while the latter can be referred to as the ‘legal place of effective management’.”¹²⁸⁶

¹²⁸⁴ See ch 2.2.4.

¹²⁸⁵ For a summary of academic authors’ view on the meaning of POEM, see Hattingh in *Residence of Companies under Tax Treaties and EC Tax Law* 707; Gutuza (2012) 24 SA Merc LJ 424 427, Olivier and Honiball *International Tax: a South African Perspective* 28 and Muller *Determining the Residence of a Trust: a South African Income Tax Perspective* 229–235.

¹²⁸⁶ Gutuza (2012) 24 SA Merc LJ 424 428.

It is submitted that the court in *Oceanic Trust* used the first approach (that is, seeking the “directing mind” of the trust) to determine the question of POEM.¹²⁸⁷ Thus, the court considered the place where SIMS’s business activities were conducted and where its income was generated; the person that gave instructions on the use of the premiums and how investments should be made; the corporate structure that SIMS formed part of; the reason for SIMS’s formation in the first place; and the lack of documentation regarding trustee meetings.¹²⁸⁸ These facts considered by the court in reaching its decision that SIMS did not have its POEM in South Africa, indicate that the court wanted to determine who the “mind” was that effectively managed it.

According to Gutuza the second approach (that is, the approach that looks at the rules that give the company its juristic personality and that regulate its actions) cannot be used in the case of a trust, since the trust does not have juristic personality (although it is regarded as a person for purposes of the Income Tax Act).¹²⁸⁹ Although Gutuza is undoubtedly correct that a trust is not a juristic person, it is submitted that the document(s) (if there are any) through which a trust is formed and the rules of trust law could also be applied in the case of a trust to determine who may effectively manage it. Therefore, even though a trust does not obtain juristic personality through the trust documents or trust law, these sources still govern the functioning of the trust and on this basis the second approach identified by Gutuza can still be applied to trusts.¹²⁹⁰ Interestingly, in *Oceanic Trust* the taxpayer’s (that is, SIMS’s) argument was based on this approach. It argued that SIMS’s sole trustee, Oceanic Trust, had no links to South Africa and that SIMS could only act through its trustee (a company) and that the director of the company had never been to South Africa. All management decisions regarding SIMS were taken by the sole trustee and these were consequently taken in Mauritius. It also argued that the place where SIMS’s business activities took place and where some of its business was carried on, should not be confused with its POEM.¹²⁹¹ As stated earlier, the court applied the first approach (the directing mind approach) to determine POEM and this could serve as an indication that South African courts will apply this approach in determining the POEM of a trust.

6.3.1.3.4 Conclusions regarding the meaning of POEM

Regarding the meaning of the term POEM in South Africa, it is submitted that the term POEM as used in the Income Tax Act should be interpreted in a similar way as the term POEM in South Africa’s DTTs. Given that most of South Africa’s DTTs are based on the OECD

¹²⁸⁷ Gutuza also states that the Court in *Oceanic Trust* applied the “directing mind” approach (Gutuza (2012) 24 SA Merc LJ 424 428). In support of her view Gutuza quotes a passage from para 20 of the judgement in *Oceanic Trust*. However, this passage comes from SARS’s letter of assessment which was quoted by the court in setting out SARS’s argument. It is submitted that the court gives no indication that it agrees with this passage and it can therefore not be taken to have been adopted by the court or even “favoured” by it. Therefore, although Gutuza’s conclusion is correct, her reason cannot be agreed with.

¹²⁸⁸ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127 para 55.

¹²⁸⁹ Gutuza (2012) 24 SA Merc LJ 424 427 and 429.

¹²⁹⁰ Gutuza acknowledges that if this approach were used in *Oceanic Trust*, the first matter to be considered would be the role and decision making by the trustees (Gutuza (2012) 24 SA Merc LJ 424 429). Support for the view set forth above may be found in Muller *Determining the Residence of a Trust: a South African Income Tax Perspective* 244.

¹²⁹¹ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127 para 48.

MTC, the meaning of the term POEM in terms of the tiebreaker provision of the OECD MTC is important. This meaning is discussed below.¹²⁹²

Furthermore, SARS's view regarding POEM, as expressed in their Interpretation Note and insofar as it focuses on implementation, is clearly not the interpretation that will be followed. This is evident from *Tradehold* and *Oceanic Trust* and SARS has indicated in its Discussion Paper that it will not pursue this interpretation. Thus it is the place of decision-making that will be relevant in determining the place of effective management for South African purposes. To the extent that SARS's Interpretation Note relied on a lower level of management than the top level of management, the decisions in *Tradehold* and *Oceanic Trust* indicate that the tide has turned towards top level management. In *Tradehold*, a decision at board level was regarded as effective management. In *Oceanic Trust*, the court, adopting the *Smallwood* test, stated that POEM is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made. The POEM will ordinarily be the place where the most senior group of persons (for example, a board of directors) makes its decision and where the actions to be taken by the entity as a whole are determined.

Therefore, both as regards decision-making (and not implementation) and the level of decision-making, the South African domestic law position corresponds in broad terms to the position set out by the OECD in their Commentary to article 4(3).¹²⁹³

If a South African court is asked to determine the POEM of a trust, it is likely to adopt the directing mind approach. Following the approach in *Tradehold* and *Oceanic Trust*, the POEM of a trust for South African domestic law purposes will be where the highest level of management is exercised. Usually the trustees will exercise this level of management, although this is not always the case (as was illustrated in *Oceanic Trust*). In the final analysis all the facts and circumstances of a particular case will have to be considered.¹²⁹⁴

6.3.1.4 Is it possible to change a trust's residence?

Once established or formed in South Africa, a trust can only change its residence if it is deemed to be exclusively a resident of another country for purposes of the application of a DTT.¹²⁹⁵ Typically, POEM would be used in a treaty as a tiebreaker, as it is in article 4(3) of the OECD MTC, to determine where a trust is resident for purposes of a treaty. One would

¹²⁹² See ch 6.4.3.

¹²⁹³ See ch 6.4.3.

¹²⁹⁴ See ch 6.4.4.

¹²⁹⁵ The Companies Act 71 of 2008 s 13(5) allows a "foreign company" to "transfer its registration to the Republic from the foreign jurisdiction in which it is registered, and thereafter exist as a company in terms of this Act as if it had been originally so incorporated and registered", provided that the conditions set out in ss 13(6) and (7) are met. Although a trust (whether or not it was established within or outside the Republic) is included in the definition of "juristic person" in s 1 of the Companies Act 71 of 2008, s 13(5) clearly applies only to a "foreign company". In turn, a "foreign company" is defined as meaning "an entity incorporated outside the Republic, irrespective of whether it is (a) a profit, or non-profit, entity; or (b) carrying on business or non-profit activities, as the case may be, within the Republic." It is submitted that the reference to incorporation in this definition excludes trusts, since trusts are seldom incorporated entities and in none of the jurisdictions under discussion in this dissertation are trusts incorporated. It is thus submitted that a foreign trust (that is not incorporated) will not be able to transfer its registration to South Africa in terms of the Companies Act.

therefore have to determine whether any DTT may be applied to a trust that was established or formed in South Africa and, if so, whether POEM is used as a tiebreaker. Assuming that these two conditions are met, it would therefore be possible to change the residence of a trust by moving its POEM to a state outside South Africa. The decision in *Tradehold*¹²⁹⁶ illustrates how the POEM of a company was changed, namely by resolving that all future directors' meetings would be held in Luxembourg. By analogy, one could argue that under certain circumstances a decision by the trustees of a trust to hold all further trustee meetings in another state, would result in a change in the trust's POEM and therefore a change in its residence.

In the case of a trust that was not established or formed in South Africa, but which has its POEM in South Africa and is, accordingly, resident in South Africa, a change in residence will similarly be achieved by a change in the POEM of the trust (on the assumptions that a DTT applies and that POEM is the tiebreaker).

Trusts that are not resident in South Africa may become resident in South Africa by moving its POEM to South Africa. From a trust law perspective it should be noted that foreigners may be appointed as trustees in respect of trust property in South Africa.¹²⁹⁷ The Trust Property Control Act also empowers the Master to authorise a trustee who is appointed outside South Africa, but who has to administer property in South Africa.¹²⁹⁸

6.3.2 United Kingdom

6.3.2.1 The Income Tax Act 2007

The position of trusts is governed by the Income Tax Act 2007. It provides that, except where the context otherwise requires, "the trustees of a settlement are together treated as if they were a single person (distinct from the persons who are the trustees of the settlement from time to time)".¹²⁹⁹ According to Schwarz, this provision bestows collective juristic personality on the trustees and means that they are "to be treated as a single 'deemed person' for the purposes of the Taxes Act unless the context requires otherwise".¹³⁰⁰ The Income Tax Act 2007 further provides that if all the trustees of a trust are United Kingdom residents, the single person (that is the trustees as "deemed person") will be United Kingdom resident and ordinarily United Kingdom resident.¹³⁰¹ Thus, the trustees of the trust must be identified and their actual place of residence in their personal capacities must be determined, applying

¹²⁹⁶ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

¹²⁹⁷ *Cameron et al Honoré's South African Law of Trusts* 205.

¹²⁹⁸ Trust Property Control Act 57 of 1988 s 8.

¹²⁹⁹ Income Tax Act 2007 s 474(1). It continues in s 474(2) to state that if different parts of the settled property in relation to a settlement are vested in different bodies of trustees, subsection (1) and sections 475 and 476 apply in relation to the different bodies as if they were all one body. Subsection 3 provides an example.

¹³⁰⁰ Schwarz *Booth & Schwarz: Residence, Domicile and UK Taxation* 130.

¹³⁰¹ Income Tax Act 2007 s 475(2) and (4); Schwarz *Booth & Schwarz: Residence, Domicile and UK Taxation* 130. The relevance of the distinction between "resident" and "ordinarily resident" is that residence is the "central determinant of liability", while "ordinarily resident" determines liability only in certain special cases and may even limit the liability to United Kingdom taxation (Schwarz *Booth & Schwarz: Residence, Domicile and UK Taxation* 61).

either the test for individual or corporate residence, depending on the nature of the trustee.¹³⁰² If all the trustees are not United Kingdom residents, this rule will not apply.

If at least one trustee is United Kingdom resident and at least one trustee is non-United Kingdom resident, the single person (that is the trustees as “deemed person”) will be United Kingdom resident and ordinarily United Kingdom resident, if a settlor in relation to the settlement (the trust) meets a further condition. This further condition depends on whether the settlement arose on the death of the settlor or not. If the settlement arose on the death of the settlor,¹³⁰³ and immediately before the settlor’s death he or she was United Kingdom resident, ordinarily United Kingdom resident or domiciled in the United Kingdom, then the condition is met from the time of the settlor’s death until the settlor ceases to be a settlor in relation to the settlement.¹³⁰⁴ In the case where the settlement does not arise on the death of the settlor and at a time when the settlor made the settlement, the settlor was United Kingdom resident,¹³⁰⁵ ordinarily United Kingdom resident or domiciled in the United Kingdom, then the condition is met from that time until the settlor ceases to be a settlor in relation to the settlement.¹³⁰⁶

Thus, in the case where at least one trustee is United Kingdom resident and at least one trustee is non-United Kingdom resident, the emphasis changes from the trustees to the settlor and it is irrelevant where the majority of trustees are resident.¹³⁰⁷ It should also be noted that if the settlor was not United Kingdom resident, ordinarily United Kingdom resident or domiciled in the United Kingdom, the trustees will not be resident or ordinarily resident in the United Kingdom.¹³⁰⁸ Transfers of property between settlements may also influence trustees’ residence.¹³⁰⁹

If a non-resident person acts as a trustee of a settlement in the course of a business that the trustee carries on in the United Kingdom through a branch, agency or permanent establishment there, then it is assumed that the trustee is a United Kingdom resident for the

¹³⁰² Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 185.

¹³⁰³ Whether by will, intestacy or any other way.

¹³⁰⁴ Income Tax Act 2007 s 476(2).

¹³⁰⁵ Or is treated for the purposes of the Income Tax Acts as making the settlement.

¹³⁰⁶ Income Tax Act 2007 s 476(3). It does not matter if the trustee later becomes a United Kingdom resident or domiciled there (Chamberlain and Whitehouse *Trust Taxation* para 4.03).

¹³⁰⁷ Schwarz *Booth & Schwarz: Residence, Domicile and UK Taxation* 130.

¹³⁰⁸ Provided, of course, that at least one trustee is United Kingdom resident and at least one trustee is non-resident (Schwarz *Booth & Schwarz: Residence, Domicile and UK Taxation* 131; Chamberlain and Whitehouse *Trust Taxation* para 4.03). Kessler opines that if a settlor was not UK resident at the time when the settlement was made, but later in that year, or in a subsequent year, becomes a resident, the trust will not become UK resident, since the emphasis is on the specific time when the settlor made the settlement (Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 187).

¹³⁰⁹ According to Schwarz “[I]f there is a transfer of property between settlements, and a settlor is treated as a settlor in relation to the transferee settlement as a result, and immediately before the transfer, that settlor meets the residence, ordinary residence or domicile condition as a settlor in relation to the transferring settlement, then he also meets that condition as a settlor in relation to the transferee settlement from the time he becomes such a settlor until he ceases to be such a settlor” (Schwarz *Booth & Schwarz: Residence, Domicile and UK Taxation* 131. See also Chamberlain and Whitehouse *Trust Taxation* para 4.04).

purpose of determining the residence and ordinary residence of the single person (that is, the trustees as “deemed person”).¹³¹⁰

According to HMRC the “branch” and “agency” tests apply to non-resident trustees and the “permanent establishment test” to corporate trustees.¹³¹¹ Furthermore, HMRC proposes that three questions are relevant in applying the relevant section,¹³¹² namely (a) is the trustee carrying on a business in the UK? (in this regard the business referred to is the business of providing a professional service as a trustee for a fee¹³¹³ and does not refer to the business of a particular trust that might be conducted by the trustee); (b) if the trustee is carrying on a business in the UK, is it carrying on that business through a branch, agent, or permanent establishment¹³¹⁴ in the UK?; (c) if so, is the trustee carrying on the activity of being a trustee of that particular trust in the course of its business through the branch, agent or permanent establishment? Regarding this last question, HMRC states that activities that, in line with the OECD’s commentary, are of a preparatory and auxiliary nature are not regarded as activities that are carried on by the trustee functioning as a trustee. Thus, HMRC identifies certain “core activities of a trustee” which, if carried on by the trustee, will be regarded as the activity of being a trustee. In identifying the “core activities of a trustee”, HMRC states that

“[a] trustee is the person who has a legal duty to manage the assets of that trust in the best interests of the beneficiary or beneficiaries. The trustee manages, employs and disposes of the trust assets in accordance with both the terms of the trust and the duties and responsibilities which the law places upon trustees. The core activities of a trustee would therefore be regarded as including:

- 10.1 the general administration of the trusts.
- 10.2 the over-arching investment strategy.
- 10.3 monitoring the performance of those investments.
- 10.4 decisions on how trust income will be dealt with and whether distributions should be made.”¹³¹⁵

¹³¹⁰ Income Tax Act 2007 s 476(6). See also Schwarz Booth & Schwarz: *Residence, Domicile and UK Taxation* 132.

¹³¹¹ Her Majesty’s Revenue and Customs *Trustee Residence Guidance* para 5. For further guidance on HMRC’s view, see Tax Faculty of the Institute of Chartered Accountants in England and Wales *et al Trustee Residence Taxguide*, agreed to by HMRC. Kessler agrees that this is the correct position (Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 193).

¹³¹² Her Majesty’s Revenue and Customs *Trustee Residence Guidance* para 8.

¹³¹³ A trustee who does not charge a fee or only recoups expenses, does not carry on a business - a rule that may provide relief for family trusts (Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 190).

¹³¹⁴ There is some debate as to what meaning should be attached to the permanent establishment (PE) concept, the United Kingdom domestic law definition of PE, or the treaty definition of PE (found in article 5 of the OECD MTC). Kessler’s view is that the United Kingdom domestic law definition applies, but HMRC’s view is that the relevant treaty definition applies. According to Kessler, it will often not matter which definition is used, as there is probably no difference between the United Kingdom domestic law definition of PE and the OECD MTC definition of PE and the latter definition is mostly used in actual United Kingdom treaties (Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 195).

¹³¹⁵ Her Majesty’s Revenue and Customs *Trustee Residence Guidance* para 10.

According to HMRC, non-core activities (that is, activities of a preparatory or auxiliary nature) include “information gathering meetings, including meetings with independent agents or with beneficiaries”.¹³¹⁶

6.3.2.2 Is it possible to change a trust’s residence?

A United Kingdom resident trust will become non-resident if its United Kingdom trustees resign in favour of non-resident trustees.¹³¹⁷ If the settlor was not United Kingdom resident or ordinarily resident or domiciled in the United Kingdom at the time that the settlement was funded, then the trust will become non-resident if at least one trustee is resident and at least one trustee is non-resident.

From a trust law perspective, it is possible for United Kingdom resident trustees to resign in favour of non-resident trustees. Provided that it can be shown that the beneficiaries will benefit from such an appointment, the courts will not interfere with the appointment of non-resident beneficiaries.¹³¹⁸ A trust deed may (and it is suggested, should) expressly allow for the appointment of non-resident trustees and for the change of the proper law of the trust.¹³¹⁹

A non-resident trust may become resident in the United Kingdom if all its trustees are United Kingdom resident.

In *Commissioners For Her Majesty's Revenue and Customs v Smallwood*,¹³²⁰ an attempt was made to change the residence of the trustees, by using a so-called “round the world scheme”. Mr Smallwood, a resident of the United Kingdom, created a trust for the benefit of himself and his family in 1989. Mr Smallwood, who had the power to appoint trustees, appointed a firm resident in Jersey as trustee in 1994, after the previous trustees had retired. The trust assets included shares in a United Kingdom company that, if sold, would result in a substantial liability for capital gains tax in the United Kingdom. A tax-planning exercise was undertaken in terms of which the Jersey firm resigned and a Mauritian company was appointed as trustee in December 2000. The shares were sold in January 2001, and in March 2001 the Mauritian trustees resigned and Mr Smallwood appointed himself and his wife as trustees. The taxpayer argued that at the time when the shares were sold and the capital gain was realised, the trustees were resident solely in Mauritius and that in terms of article 13(4) of the DTT between the United Kingdom and Mauritius, the United Kingdom was prevented from taxing the gains.¹³²¹ The taxpayer therefore argued that the only relevant time at which the residence of the trustees was to be determined, was at the date of disposal. According to the taxpayer, the fact that the trustees became resident in the United Kingdom after the date of disposal (and therefore became liable to tax in the United Kingdom for the whole tax year) was irrelevant for the application of the DTT. This argument

¹³¹⁶ Her Majesty's Revenue and Customs *Trustee Residence Guidance* para 11. Controversially, HMRC includes the frequency, along with the nature and importance, of activities as a criterion to determine whether a trustee was acting as such (Her Majesty's Revenue and Customs *Trustee Residence Guidance* para 12; Schwarz *Booth & Schwarz: Residence, Domicile and UK Taxation* 133).

¹³¹⁷ Chamberlain and Whitehouse *Trust Taxation* para 4.13.

¹³¹⁸ Chamberlain and Whitehouse *Trust Taxation* paras 4.14 and 4.15.

¹³¹⁹ Chamberlain and Whitehouse *Trust Taxation* para 4.16.

¹³²⁰ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778.

¹³²¹ Since Mauritius does not have capital gains tax, the gain would effectively not be taxed.

was rejected by the court. Instead it held that the term “residence” in article 4(1) of the DTT (which conformed to article 4(1) in the OECD MTC) referred to “chargeability to tax” and not “physical residence”. Therefore, even though the trustees only became residents in the period subsequent to the disposal of the shares, it made them chargeable to tax and therefore liable to tax by reason of their residence for purposes of article 4(1).¹³²²

This view meant that the tiebreaker provision in article 4(3), namely POEM, had to be applied, since the trustees were liable to tax in both the relevant states. In other words, the person is deemed to be a resident only of the state in which its POEM is situated, for purposes of the treaty. The majority of the court emphasised that it was the POEM of the trustees of the trust, as a continuing body (and not the POEM of the Mauritian trust company), that had to be determined. In this regard the majority, per Lord Justice Hughes, held that

“[t]he scheme was devised in the United Kingdom by Mr Smallwood on the advice of KPMG Bristol. The steps taken in the scheme were carefully orchestrated throughout from the United Kingdom, both by KPMG and by Quilter. And it was integral to the scheme that the trust should be exported to Mauritius for a brief temporary period only and then be returned, within the fiscal year, to the United Kingdom, which occurred. Mr Smallwood remained throughout in the UK. There was a scheme of management of this trust which went above and beyond the day to day management exercised by the trustees for the time being, and the control of it was located in the United Kingdom.”¹³²³

Thus the majority of the court held that the POEM of the trust was in the United Kingdom, which meant that the United Kingdom was entitled, in terms of the relevant DTT, to tax the gain on the sale of the shares. Thus the export of the trust to Mauritius did not have the desired effect.

6.3.3 Canada

6.3.3.1 Central management and control¹³²⁴

The Canadian Income Tax Act does not contain a definition of the term “residence” that is relevant to determine the residence of a trust and hence the term must be interpreted in accordance with general principles.¹³²⁵ In the case of *Fundy Settlement v Canada*, the Supreme Court of Canada recently pronounced on the test to be applied to determine the

¹³²² This part of the judgement has been criticised as follows: “With respect to the Special Commissioners, and to the Court of Appeal who upheld their approach, it is submitted that Article 4(1) of the Treaty cannot award treaty residence in the UK to trustees for the part of the year in which they are non-resident, simply because domestic law does not regard them as resident. The argument that the trustees were treaty resident for the purposes of Article 4(1) because they were liable (chargeable) to tax on a capital gain by reason of a period of residence starting subsequently to the gain ignores the fact that they were only liable by reason of a statutory ‘force of attraction’ provision and not because they were actually resident at the relevant time” (Cleave (2011) 6 BTR 705 709).

¹³²³ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 para 70.

¹³²⁴ Throughout this dissertation, “central management and control” is used as one concept. Both the courts and academic authors recognize it as one concept and use the singular verb in relation to it.

¹³²⁵ *Garron v R* 2009 TCC 450; 12 ITLR 79 para 123.

residence of a trust under Canadian domestic law.¹³²⁶ The facts were that a resident of Barbados, a corporation known as St Michael's Trust Corp, was the trustee of two trusts, the Fundy Settlement and the Summersby Settlement. Both trusts were formed by a person resident in St Vincent in the Caribbean, but the beneficiaries were all resident in Canada. The issue was whether the Canadian government was entitled to withholding tax on the sale of certain shares in Canadian corporations by the trusts. In terms of the tax treaty between Canada and Barbados, tax would only be payable in the state in which the seller was resident. It therefore had to be determined whether the trusts were resident in Canada.

The trustee argued that the residence of the trust was the residence of the trustee, which the Tax Court (the court of first instance) had found to be in Barbados. For the Canadian Minister of Finance (the Minister) it was argued that the appropriate test to determine the residence of a trust was the place where its central management and control was situated. The Minister argued that the central management and control of the trust was exercised by its main beneficiaries in Canada.

The court observed that there was very little authority on the question of the residency of a trust, but that the residence of corporations was determined by the central management and control test.¹³²⁷ The court quoted the well-known dictum from *De Beers Consolidated Mines, Ltd. v. Howe*:

"In applying the conception of residence to a company, we ought, I think, to proceed as nearly as we can upon the analogy of an individual. A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business. ... [A] company resides for purposes of income tax where its real business is carried on. ... I regard that as the true rule, and the real business is carried on where the central management and control actually abides."¹³²⁸

After observing that the central management and control test was adopted in Canada as the test for the residency of a corporation, the court stated that the central management and control of a corporation will generally be where its board of directors exercises its responsibilities. If, however, the facts show that the central management and control of the corporation was carried out by a shareholder, it will be resident where that shareholder is resident and making decisions.¹³²⁹ The court held that

"[a]s with corporations, residence of a trust should be determined by the principle that a trust resides for the purposes of the Act where 'its real business is carried on' (*De*

¹³²⁶ *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520. The case concerned two trusts and four other persons who were also assessed on the relevant gains. The case was first heard by the Tax Court of Canada, then the Federal Court of Appeal and lastly by the Supreme Court of Canada. The citations of the different appeal cases differ significantly, but in fact they all refer to the same matter. In this dissertation the following citations will be used to refer to the respective judgements: *Garron v R* 2009 TCC 450; 12 ITLR 79 (Tax Court of Canada), *St Michael Trust Corp as Trustee of the Fundy Settlement v Her Majesty the Queen* 2010 FCA 309 (Federal Court of Appeal) and *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520 (Supreme Court of Canada).

¹³²⁷ *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520 para 8.

¹³²⁸ *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455 (HL) 458.

¹³²⁹ *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520 para 9.

Beers, at p. 458), which is where the central management and control of the trust actually takes place.”¹³³⁰

On the facts the Tax Court had found that the trustee had a restricted role, namely to provide administrative services, and that the trustee had limited responsibility beyond that. It had further found that the main beneficiaries exercised central management and control. The Supreme Court of Appeal therefore confirmed that the trusts were resident in Canada, where its central management and control was exercised. It noted that the residence of the trust could sometimes be the residence of the trustee. This would be the case if the trustee exercises central management and control and these duties are performed where the trustee is resident.¹³³¹

In finding that the trustee had a limited role and that the main beneficiaries exercised central management and control, the Tax Court found that there was an unwritten agreement that the trustee would comply with the recommendations of the main beneficiaries and that the main beneficiaries understood this from the outset.¹³³² This unwritten agreement was enforceable through the mechanism of a protector, who was entitled to replace the trustee.¹³³³ The Tax Court took into account a number of factors to reach its decision. A director of the trustee drafted an internal memorandum suggesting that that the trustee would act in an administrative capacity only and that the trustee would make no distributions without the main trustees’ consent. The limited evidence on how the proceeds of the sale were handled, suggested that it was under the direction of the two main beneficiaries. The same tax advisers acted for the main beneficiaries and the trusts and the main beneficiaries directed the tax minimisation plans. The trustee submitted very few documents in support of its case that it played an active role in managing the trusts, whereas the documents submitted by the Minister supported the view that the trustee played a very limited role. It was questionable whether the trustee had the relevant expertise in managing trust assets. The oral evidence presented to the court was consistent with the trustee’s limited role.¹³³⁴

6.3.3.2 Income Tax Act

In terms of the Income Tax Act, a trust may be deemed to be a resident of Canada.¹³³⁵ The Canadian Department of Finance explains that the following trusts are subject to the rules contained in the relevant section:

¹³³⁰ *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520 para 15.

¹³³¹ *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520 para 15. This case is criticised by Avery Jones and Nikolakakis because the finding of the court that the trust was resident in Canada, means that the trust was dual resident, because the court implied that it was also resident in Barbados. The relevant DTT provided that in the case of dual residence “the competent authorities shall by mutual agreement endeavour to settle the question and to determine the mode of application of this Agreement” (Avery Jones and Nikolakakis (2012) 14 *International Tax Law Reports* 1090 1097). Cleave raises essentially the same point in relation to the Federal Court of Appeal’s decision (Cleave (2011) 6 *BTR* 705 712).

¹³³² *Garron v R* 2009 TCC 450; 12 ITLR 79 para 194.

¹³³³ *Garron v R* 2009 TCC 450; 12 ITLR 79 para 191.

¹³³⁴ *Garron v R* 2009 TCC 450; 12 ITLR 79 paras 196–252.

¹³³⁵ Income Tax Act RSC 1985 (5th supp) ch 1 s 94(3). See ch 3.4.6 for a more detailed discussion of this section.

“In general, a trust (other than an exempt foreign trust) will be subject to tax for a taxation year as a trust resident in Canada if a contribution was made to the trust by a person (other than a recent immigrant to Canada or an exempt person) that is resident in Canada at a specified time (generally, the end of the year). In addition, a trust (other than an exempt foreign trust) will generally be subject to Canadian tax for a taxation year if there is a resident beneficiary under the trust. More specifically, if: a contribution was made by a person when the person was resident in Canada (or generally within a 60-month period before the person became resident in Canada or within a 60-month period after the person ceased to be resident in Canada), where the contributing person is an individual (other than a trust), at the specified time the individual had been resident in Canada for more than 60 months, and at the specified time there is a person (other than a successor beneficiary) that is resident in Canada and is a beneficiary under the trust.”¹³³⁶

As stated above, the court in *Garron*¹³³⁷ held, on the previous version of this provision, that if such a deeming provision applied, the trust would not be liable to tax by reason of its residence for purposes of the relevant treaty. Residence by virtue of this deeming provision would therefore not result in treaty residence. However, in 2013, the Income Tax Conventions Interpretation Act was amended by the inclusion of the following provision:

“Notwithstanding the provisions of a convention or the Act giving the convention the force of law in Canada, if a trust is deemed by subsection 94(3) of the *Income Tax Act* to be resident in Canada for a taxation year for the purposes of computing its income, the trust is deemed to be a resident of Canada, and not a resident of the other contracting state, for the purposes of applying the convention (a) in respect of the trust for that taxation year; and (b) in respect of any other person for any period that includes all or part of that taxation year.”¹³³⁸

Thus, by virtue of this provision, a trust that is deemed to be resident in Canada for purposes of the relevant section of the Income Tax Act, is also deemed to be resident in Canada for purposes of a DTT.

6.3.3.3 Is it possible to change a trust’s residence?

It is submitted that the residence of a trust may be changed by moving the central management and control of a trust. Some authors state that the residence of a trust may change if the trustee ceases to reside in Canada or if the trustee is replaced by a non-resident trustee.¹³³⁹ This statement is only correct insofar as the trustee, in fact, manages and controls the trust and such management and control takes place where the trustee resides.¹³⁴⁰ It is submitted that the better test will be to find the person(s) who manage and

¹³³⁶ Minister of Finance *Explanatory Notes Relating to the Income Tax Act, the Excise Tax Act and Related Legislation*.

¹³³⁷ *Garron v R* 2009 TCC 450; 12 ITLR 79 para 316 and *St Michael Trust Corp as Trustee of the Fundy Settlement v Her Majesty the Queen* 2010 FCA 309 para 87. Although the matter went on appeal to the Supreme Court of Canada (*Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520), this point was not decided by that court.

¹³³⁸ Income Tax Conventions Interpretation Act RSC 1985 c I-4 s 4.3.

¹³³⁹ *Ewens Canada Tax Service - McCarthy Tetrault Analysis* s 104 21; Brown in *Topical Analysis* para 4.1.2.

¹³⁴⁰ *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520 para 15.

control the trust¹³⁴¹ and to examine whether such management and control has moved. The movement of the central management and control of a trust may take place because the *person(s)* who manage and control the trust changed, for example, by appointing a new trustee(s) who is a non-resident. The central management and control of a trust may also move, because the *place* where central management and control is exercised has changed – for example, a trustee exercises central management and control from a different place, because all trustee meetings are held at a different place.

6.3.4 The Netherlands

The *Wet op de vennootschapsbelasting* (the Dutch corporate income tax legislation) provides that if an entity is formed in terms of Dutch law, it is deemed to be a resident of the Netherlands.¹³⁴² Since trusts are not formed in terms of Dutch law, this provision will not apply to determine a trust's residence.

Earlier, the view was taken that a trust does not, generally speaking, fall within one of the categories that would be liable to corporate income tax as a resident.¹³⁴³ However, if this view is not correct and if a trust could be classified as one of the entities listed in the *Wet op de vennootschapsbelasting*,¹³⁴⁴ it may be liable for Dutch corporate income tax.¹³⁴⁵ In terms of the *Algemene wet inzake ryksbelasting*, the place where an individual resides and an entity is settled, is determined according to the circumstances.¹³⁴⁶ The circumstances under which an entity will be regarded as resident in the Netherlands are not set out in the legislation. Rather, it has been left to the courts to determine those circumstances.¹³⁴⁷ In this regard the courts have held that the place of effective management of a company is usually conclusive. Other factors that will be taken into account include the place of residence of the directors, the place where board meetings take place, the place where the company has its head office and the place where the shareholders are resident.¹³⁴⁸ Regarding the meaning of place of effective management, it is the higher level of strategic management that is taken into account, rather than the day-to-day management. The courts have also formulated a rule that assumes that the effective management of a company is in the hands of its board of directors, although there may be exceptions.¹³⁴⁹

Translating these rules to trusts, it is submitted that a trust will be resident in the Netherlands if its place of effective management is in the Netherlands. Usually, a trust's high-level strategic management is carried out by its trustees and it will therefore be

¹³⁴¹ See ch 6.4.4.

¹³⁴² *Wet op de vennootschapsbelasting* 1969 s 2(4).

¹³⁴³ See ch 3.5.2.

¹³⁴⁴ *Wet op de vennootschapsbelasting* 1969.

¹³⁴⁵ See ch 3.

¹³⁴⁶ *Algemene wet inzake rijksbelasting* s 4(1). The Dutch text reads as follows: "Waar iemand woont en waar een lichaam gevestigd is, wordt naar de omstandigheden beoordeeld". This section has been translated as follows: "The place of residence of an individual or an entity [lichaam] is determined according to circumstances" (De Boer in *Residence of Companies under Tax Treaties and EC Law* 560).

¹³⁴⁷ De Boer in *Residence of Companies under Tax Treaties and EC Law* 561; Kusters (2011) *Country Analyses IBFD* para 1.1.5.

¹³⁴⁸ De Boer in *Residence of Companies under Tax Treaties and EC Law* 562; Kusters (2011) *Country Analyses IBFD* para 1.1.5.

¹³⁴⁹ De Boer in *Residence of Companies under Tax Treaties and EC Law* 563.

assumed (as is done in the case of companies) that the trustees effectively manage a trust. Other factors that may play a role to determine whether a trust is resident in the Netherlands include the place of residence of the trustees, the place where trustee meetings take place and the place where the beneficiaries are resident. However, a contrary view is held by Boer. He argues that since a trust is usually managed by its trustees, it will usually be resident where the majority of trustees are resident or settled.¹³⁵⁰

It should, however, be borne in mind that it is doubtful whether a trust will be subject to corporate income tax as resident and it is only if it is so liable that it will be regarded as liable to tax for purposes of a DTT. If a trust is not a resident, it may be liable to corporate income tax as a *doelvermogen* (purpose fund). However, since it will only be liable to tax on Dutch income, no comprehensive liability to tax will arise and such trusts will, accordingly, not be regarded as liable to tax in the Netherlands for DTT purposes.

Prior to the introduction of the concept of *afgezonderd particulier vermogen* (APV) in the Dutch income tax legislation for individuals, trusts and trustees were not liable to income tax on trust income.¹³⁵¹ Thus, a trust could not be a resident for treaty purposes, since it was not liable to tax and it is submitted that this position will still apply to trusts that do not qualify as APVs. If a trust is regarded as an APV, its income is, generally speaking, attributed to the settlor. It is therefore submitted that it will not be regarded as a resident for treaty purposes, since it is not liable to tax.

6.4 Dual residence and the tiebreaker provision

6.4.1 Introduction: Which tiebreaker should be applied and to whom?

Article 4 contains two tiebreaker provisions which determine where a person, who is regarded as a resident by both state parties to the DTT, will be resident for purposes of the treaty.¹³⁵² A person can only be resident in one state for purposes of the treaty. The first¹³⁵³ of the two tiebreakers applies to individuals and the second, which uses the criterion of POEM,¹³⁵⁴ to persons other than individuals.

In this regard, the question arises which of these two tiebreakers should be applied to trusts. Case law in the United Kingdom and Canada suggests that the second tiebreaker should be applied to trusts. The OECD Commentary in respect of the second tiebreaker (that is, POEM) states that this tiebreaker “concerns companies and other bodies of persons, irrespective of whether they are or not legal persons”.¹³⁵⁵ Earlier in this dissertation it is argued that in

¹³⁵⁰ Boer *De Anglo-Amerikaanse trust in de inkomsten- en vennootschapsbelasting* 302.

¹³⁵¹ Auerbach in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 243.

¹³⁵² The application of this article assumes that both states regard the trust as resident in that state. States that do not view a trust as a person that is liable to tax and therefore a resident (eg if a state views a trust as a transparent entity), will, obviously, not apply this provision to trusts. If, however, Lang’s view (which is discussed in ch 6.2.2.2.3) is applied, it is not necessary for a trust to be a taxable entity. As long as there is a close connection with a state of residence, it will be regarded as resident in the state of residence.

¹³⁵³ OECD MTC art 4(2).

¹³⁵⁴ OECD MTC art 4(3) reads as follows: “Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated”.

¹³⁵⁵ Commentary on the OECD MTC art 4 para 21.

South Africa, trusts are not bodies of persons, but that the trustees of a trust are a body of persons in the United Kingdom and, maybe, in the Netherlands.¹³⁵⁶ Applying the OECD Commentary, the second criterion should therefore be applied in the United Kingdom (and possibly the Netherlands) to the trustees of a trust. As set out in the Commentary, the fact that the trustees are not a juristic person, is irrelevant and article 4(3) should be applied. It was also argued in this dissertation that a trust is not a company (as defined in the OECD MTC) in any of the states under review.¹³⁵⁷ Thus, from a South African perspective, it may be argued that the Commentary suggests that article 4(3) should not be applied to trusts. The counter argument would be that the alternative tiebreaker (article 4(2)) which applies to individuals, cannot apply to a trust, because a trust simply is not an individual and the tests postulated in that article are inappropriate for trusts. Since trusts are “persons” and can be “resident” for purposes of the OECD MTC, one of the two tiebreakers must be applied to determine treaty residence in the case of dual residence and it is therefore submitted that article 4(3) is the most appropriate tiebreaker.

In Canada, the Income Tax Act provides that a trust will be deemed to be an individual¹³⁵⁸ and the question arises whether article 4(2), the tiebreaker for individuals, should be applied. Usually a trust is, along with an individual, included in the definition of “person” in DTTs. According to Avery Jones *et al*, article 4(3) (that is, POEM) and not article 4(2), should therefore be applied to dual resident trusts.¹³⁵⁹ If a trust is not included in the definition of “person” in the Canadian DTT, Avery Jones *et al* argue that the tests laid down in article 4(2) are inappropriate and therefore inapplicable to trustees and if that argument prevails, article 4(3) should be applied.¹³⁶⁰

Looking at case law for guidance, in the United Kingdom case of *Wensleydale's Settlement Trustees v Inland Revenue Commissioners*,¹³⁶¹ the second tiebreaker (that is POEM) contained in the DTT between the United Kingdom and the Republic of Ireland was applied to the trustees in that case. The court gave no reasons for applying POEM as a tiebreaker. In *Smallwood*,¹³⁶² both the majority and the minority applied the second tiebreaker (that is, POEM) to determine the residence of the trustees for purposes of the DTT between the United Kingdom and Mauritius. Again the court gave no reasons for applying this second tiebreaker. However, it will be recalled that trustees of the trust were, consecutively, a Jersey firm, a Mauritian company and, lastly, Mr and Mrs Smallwood. Therefore, even though some of the trustees were individuals, the court did not apply the tiebreaker provision for individuals (article 4(2)), but rather article 4(3), and it may be deduced that that article is the appropriate tiebreaker provision to be applied in respect of trustees of a trust. In the Canadian *RCI Trust* case,¹³⁶³ the court indicated that the second tiebreaker would

¹³⁵⁶ See ch 5.2.3 and 5.2.5 respectively.

¹³⁵⁷ See ch 5.1 and 5.3 respectively.

¹³⁵⁸ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(2).

¹³⁵⁹ Avery Jones (1989) 3 BTR 65 67 and footnote 8.

¹³⁶⁰ Avery Jones (1989) 3 BTR 65 67. This point is criticised by Prebble (Prebble (2004) 2 *eJournal of Tax Research* 4).

¹³⁶¹ *Wensleydale's Settlement Trustees v IRC* [1996] STC (SCD) 241.

¹³⁶² *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778.

¹³⁶³ *Robert MO Morris and Neville Leroy Smith Trustees of the RCI Trust v Minister of National Revenue* 2009 FC 434.

apply to a trust, although the court in that case declined to apply the tiebreaker.¹³⁶⁴ In *RCI Trust* the DTT defined a person to include a trust,¹³⁶⁵ thereby confirming the position taken by Avery Jones *et al*.

Academic authors also suggest that the second tiebreaker (that is, POEM) should be applied. Baker,¹³⁶⁶ Oliver and Harris,¹³⁶⁷ Kessler,¹³⁶⁸ and Edwardes-Ker¹³⁶⁹ all suggest that article 4(3) should be applied to trusts. Avery Jones *et al* suggest that the second tiebreaker would be used in *inter alia* Canada and the United Kingdom.¹³⁷⁰ Booth and Schwarz, commenting on the United Kingdom position, agree that dual residence may be resolved through article 4(3).¹³⁷¹ Schwarz bases his view that the dual residence of a trust is addressed by article 4(3) on the fact that a trust is not an individual.¹³⁷² Academic authors commenting on the South African position agree that POEM will be used as the tiebreaker.¹³⁷³

It is submitted that South African courts will follow the precedent set by the courts in the states mentioned above and the opinion of academic authors, thereby applying the second tiebreaker provision (that is, POEM) to trusts.¹³⁷⁴ However, in order to address the possible uncertainty created by the Commentary to article 4(3), it is suggested that South Africa should insert a reservation to the Commentary indicating that it will apply the POEM tiebreaker in relation to trusts.

Further questions regarding the application of the tiebreaker provision to trustees are raised by Wheeler:

“Does it apply to the trustees as such, or to all the trustees as a body of persons, or to trustees in their personal capacity?”¹³⁷⁵

In respect of the United Kingdom, where the questions raised by Wheeler may be relevant, Kessler provides a solution. He suggests that in terms of United Kingdom domestic tax law, the trustees (whether there is one or more than one) are regarded as a body of persons and that this “trustee-person” (to use Kessler’s term) is distinct from the persons who are the trustees. For treaty purposes it is the residence of this trustee-person that should be

¹³⁶⁴ The case was appealed to the Federal Court of Appeal (*The Minister of National Revenue v. Robert MO Morris* 2009 FCA 373) and overturned on a technical point. The judgement of the Federal Court of Appeal did not address the application of the residence tiebreaker in the relevant DTT.

¹³⁶⁵ *Robert MO Morris and Neville Leroy Smith Trustees of the RCI Trust v Minister of National Revenue* 2009 FC 434 para 3.

¹³⁶⁶ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 4B.16.

¹³⁶⁷ Harris and Oliver *International Commercial Tax* 66.

¹³⁶⁸ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 230.

¹³⁶⁹ Edwardes-Ker *Tax Treaty Interpretation* 51.12.

¹³⁷⁰ Avery Jones (1989) 3 BTR 65 67.

¹³⁷¹ Schwarz Booth & Schwarz: *Residence, Domicile and UK Taxation* 134.

¹³⁷² Schwarz Schwarz on *Tax Treaties* 111.

¹³⁷³ Honiball and Olivier *The Taxation of Trusts in South Africa* 291; Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* 339.

¹³⁷⁴ It should be borne in mind that *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127 dealt with the application of POEM in terms of domestic legislation and cannot be used as authority for the view that in South Africa, POEM is the preferred tiebreaker in a treaty context.

¹³⁷⁵ Wheeler in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 50.

determined and, naturally, the trustees' personal capacity is irrelevant. It is submitted that reference to the United Kingdom domestic tax law is relevant in the present circumstances, as article 4(3) itself requires determination of liability in terms of domestic legislation.

The advent of the Internet and the advance in communication means using electronic resources have significantly affected the application of POEM. It is no longer a given that a group of people will meet in one place to take a decision, because technology enables them to 'meet' electronically and take decisions, irrespective of where they are physically located.¹³⁷⁶ It has also enabled senior management and boards to increase their mobility, making it difficult to tie effective management down to one place.¹³⁷⁷ The same would hold true for the trustees of a trust and its effective management.¹³⁷⁸

In this paragraph a number of issues regarding the POEM tiebreaker will be addressed. First it will be examined whether a person's domestic residence for part of the tax year may result in treaty residence in terms of article 4(3) for the whole tax year. Next the meaning of the term POEM in the OECD MTC will be discussed and, finally, the question of who exercised the POEM of a trust is addressed.

6.4.2 Concurrent *versus* consecutive residence and the meaning of "residence" in terms of article 4(3)

According to Schwarz a person can be dually resident in two contexts where the treaty will be required to resolve the matter. Firstly, a person may be concurrently continuously resident in two states where both states regard the person as a resident during the same period in terms of their domestic laws. Secondly, a person may be consecutively resident in two states, by moving residence from one state to another and therefore being resident in both states, but at different times. According to Schwarz, the residence of the taxpayer must, in the second case, be tested at the time the relevant income arises.¹³⁷⁹ Hence the taxpayer will only be resident in one of the states at that point in time.¹³⁸⁰ However, in the *Smallwood*-case, the Special Commissioners¹³⁸¹ decided that liability to tax under United Kingdom domestic law resulted in treaty residence in terms of article 4(1). In other words, under United Kingdom domestic law a person is liable to the relevant tax during a year of assessment, even though that person is only resident in the United Kingdom for a particular period during the year of assessment. The Special Commissioners held that liability which extended over the full year of assessment had to be equated to residence (for purposes of the treaty) for the year of assessment. This view was eventually confirmed on appeal when the court held:

"The definition of 'resident' in Article 4(1) is expressly subject to Article 4(3) which therefore applies whenever the alienator is liable to taxation in both Contracting States in respect of the gain. Article 4(3), as I have explained, is focused on liability for

¹³⁷⁶ Oguttu (2008) 41 *Comparative and International LJ* 80 89.

¹³⁷⁷ Oguttu (2008) 41 *Comparative and International LJ* 80 90.

¹³⁷⁸ Since the issue of the effect of electronic communication means on POEM is not limited to trusts and forms a field of study on its own, this point will not be further discussed in this dissertation.

¹³⁷⁹ Schwarz *Schwarz on Tax Treaties* para 14–200.

¹³⁸⁰ *Smallwood v The Commissioners for Her Majesty's Revenue and Customs* [2009] EWHC 777 (Ch) para 46.

¹³⁸¹ *Trevor Smallwood Trust v The Commissioners for Her Majesty's Revenue and Customs* (2008) Sp C 669. The Special Commissioners constitute the court of first instance.

tax regardless of the period of residence under national law which creates that liability. Looked at in this way it becomes meaningless and impermissible to draw a distinction between consecutive and concurrent periods of 'residence'." ¹³⁸²

Kessler describes the judgement as "in part somewhat muddled", but suggests the reasoning that the court could have followed to reach the same decision. He states that the Mauritian trustees were liable to tax in the United Kingdom during the period of Mauritian residence not by reason of *theirs* (that is, the Mauritian trustees' residence), but because of another's residence (that is, the Smallwoods, who were residents of the UK, but only became trustees subsequent to the Mauritian trustees). The court, however, viewed the trustees as a continuing body of persons, distinct from the individual trustees. It concluded that the trustees were residents in the United Kingdom during the Mauritian period, because they were liable to tax in the United Kingdom during the Mauritian period and they were liable by reason of the trustees' (as a continuing body) residence in the subsequent UK period. The fact that the trustees did not know that "they" would become residents in the United Kingdom during the Mauritian period, was irrelevant. The court held that the matter of liability had to be decided retrospectively. ¹³⁸³

6.4.3 The meaning of POEM in the OECD MTC

6.4.3.1 The OECD Commentary on article 4(3)

The term POEM was first introduced into the OECD MTC in 1963. However, prior to 2000 the Commentary provided little guidance on the meaning of the term. ¹³⁸⁴ In 2000 the following paragraph was added to the Commentary:

"As a result of these considerations, the 'place of effective management' has been adopted as the preference criterion for persons other than individuals. The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made. The place of effective management will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole are determined; however, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time." ¹³⁸⁵

This paragraph in the Commentary was again amended in 2008 and it now reads as follows:

"As a result of these considerations, the 'place of effective management' has been adopted as the preference criterion for persons other than individuals. The place of

¹³⁸² *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 para 43. Cleave's criticism of this point is set out in ch 6.3.2.2.

¹³⁸³ Kessler *Taxation of Non-Residents and Foreign Domiciliaries* 218.

¹³⁸⁴ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 4B.16. For a discussion of the history of art 4(3) and the commentary thereon, see Attard in *History of Tax Treaties The relevance of the OECD Documents for the Interpretation of Tax Treaties* 203–228.

¹³⁸⁵ Commentary on the OECD MTC art 4(3) para 24.

effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time."

The differences between the 2000 and 2008 wording of the Commentary are indicated in the following paragraph:

"As a result of these considerations, the 'place of effective management' has been adopted as the preference criterion for persons other than individuals. The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business **as a whole** are in substance made. ~~The place of effective management will ordinarily be the place where the most senior person or group of persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole are determined; however, no definitive rule can be given and~~ All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time."

According to Sassville these amendments have the effect of supporting both the "management of the top-level executives" view and the "managed by the board of directors" view.¹³⁸⁶ It is submitted that with the above amendments, the OECD suggests that a lower level of management (such as senior executives) as opposed to the highest level of management (such as a board of directors) can be responsible for the key management and commercial decisions of a business. The 2008 changes to the Commentary also saw the introduction of an alternative version of article 4(3) which countries may choose to adopt. The alternative provision states that if an entity is a resident of both contracting states, the competent authorities of the contracting states shall endeavour to determine by mutual agreement the contracting state of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to a number of criteria, which includes its POEM. In the absence of such an agreement, the entity shall not be entitled to any relief or exemption from tax provided by the DTT except to the extent and in such manner as may be agreed upon by the competent authorities.¹³⁸⁷

6.4.3.2 Cases on the meaning of POEM

In the United Kingdom case of *Wensleydale's Settlement Trustees v Inland Revenue Commissioners*,¹³⁸⁸ the court had to decide whether a trust's POEM was in Ireland. In this case there were two trustees – one was the settlor's solicitor in England and the other was

¹³⁸⁶ Sassville in *Residence of Companies under Tax Treaties and EC Law* 295. These views correspond with what SARS has called the "board-centric approach" and the "continental approach" (see ch 6.3.1.3.2). For criticism against these amendments, see Hattingh in *Residence of Companies under Tax Treaties and EC Tax Law* 734–736.

¹³⁸⁷ Commentary on the OECD MTC art 4(3) para 24.1.

¹³⁸⁸ *Wensleydale's Settlement Trustees v IRC* [1996] STC (SCD) 241. This case will be discussed more fully in ch 6.4.4.

the wife of a solicitor in Ireland. The trustees argued that, for purposes of the DTT between the United Kingdom and Ireland, the POEM of the trust was in Ireland. The court held that the word “effective” in the expression POEM implies “realistic positive management”. It added that the POEM is “where the shots are called”.¹³⁸⁹ In the end, the court held that the POEM of the trust was not in Ireland.

In *Wood v Holden (Inspector of Taxes)*¹³⁹⁰ the High Court in the United Kingdom did not express an opinion on the meaning of POEM. However, it did strongly suggest that the POEM test in article 4(3) and the test of central management and control (the test for residence of certain companies in the United Kingdom domestic law) were the same, or would, on the facts before it, lead to the same result.¹³⁹¹ In that case, Mr and Mrs Wood held most of the shares in an operating company and they wished to dispose of those shares without incurring a large tax charge. They were advised by Price Waterhouse to embark on a scheme which involved the creation of certain offshore settlements. The trustees of these settlements incorporated a company (known as CIL) in the British Virgin Islands. Mr and Mrs Wood had transferred a number of shares in the operating company to a holding company, of which they were the only shareholders. Mr and Mrs Woods then transferred a number of shares in the holding company to CIL. CIL subsequently also acquired all the shares in a dormant Dutch company (known as Eulalia). ABN AMRO Trust Co was appointed as the only managing director of Eulalia. Within a few days, CIL sold its shares in the holding company to Eulalia. The purchase price was funded by a loan by CIL to Eulalia. After approximately three months, Eulalia sold its shares in the holding company to an outside purchaser.

The revenue authority claimed that Eulalia was resident in the United Kingdom, which would have meant that Mr and Mrs Wood were still liable for capital gains tax on the sale of the shares in the holding company by CIL to Eulalia. The test for residence in the United Kingdom is that of central management and control and the court of first instance (the Special Commissioners) found that Eulalia’s central management and control was in the United Kingdom. The judgement was based on the following reasoning. The responsibility for the day-to-day management of Eulalia was with ABN AMRO, whose appointment was prompted by Price Waterhouse. There was no evidence that ABN AMRO had considered the price at which the shares in the holding company were purchased by Eulalia, nor did they receive any advice on the matter. However, Eulalia was purchasing the shares from its holding company and the purchase itself did not inevitably give rise to the conclusion that Eulalia had handed over central management and control to CIL. Eulalia’s only activities were the acquisition and sale of the shares in the holding company and matters related thereto. Although there were strong commercial reasons for Eulalia to sell the shares in the holding company to the outside purchaser, ABN AMRO did not really consider the terms of the sale and simply complied with Mr Wood’s wishes. The Special Commissioners further held that ABN AMRO’s failure to consider the terms of the purchase and sale of the shares in the holding company had the effect that the actual effective decision was not taken by ABN AMRO in Amsterdam.¹³⁹²

¹³⁸⁹ *Wensleydale's Settlement Trustees v IRC* [1996] STC (SCD) 241 para 7(2).

¹³⁹⁰ *Wood v Holden (Inspector of Taxes)* [2006] EWCA Civ 26.

¹³⁹¹ *Wood v Holden (Inspector of Taxes)* [2006] EWCA Civ 26 1396.

¹³⁹² *Wood v Holden (Inspector of Taxes)* [2006] EWCA Civ 26 1407.

The decision of the Special Commissioners was overturned on appeal and when the revenue authority appealed that decision, the High Court again held in favour of the taxpayer. The High Court held that

“[i]n seeking to determine where ‘central management and control’ of a company incorporated outside the United Kingdom lies, it is essential to recognise the distinction between cases where management and control of the company is exercised through its own constitutional organs (the board of directors or the general meeting) and cases where the functions of those constitutional organs are ‘usurped’ – in the sense that management and control is exercised independently of, or without regard to, those constitutional organs. And, in cases which fall within the former class, it is essential to recognise the distinction (in concept, at least) between the role of an ‘outsider’ in proposing, advising and influencing the decisions which the constitutional organs take in fulfilling their functions and the role of an outsider who dictates the decisions which are to be taken. In that context an ‘outsider’ is a person who is not, himself, a participant in the formal process (a board meeting or a general meeting) through which the relevant constitutional organ fulfils its function.”¹³⁹³

The High Court therefore held that Eulalia was resident in the Netherlands. This decision was based on the fact that the directors of Eulalia were not bypassed and did not stand aside, since the representatives of the managing director signed or executed the documents. Therefore, in Eulalia’s case, the functions of the directors were not usurped, as referred to in the quotation above. Furthermore, the High Court found that the representatives of the managing director did indeed make a decision to enter into the agreements of sale and purchase. There was no evidence that Price Waterhouse dictated to ABN AMRO which decisions they were to make, although the court acknowledged that Price Waterhouse intended and expected AMN AMRO to make the decisions that they did. The court found that the flaw in the Special Commissioners’ approach was to treat the two crucial decisions taken by ABN AMRO (namely to purchase and sell the shares in the holding company) as if they were not effectively taken by the managing director exercising management and control. These two decisions were the only management that had to be done. The court further held that the fact that ABN AMRO did not have proper information, did not mean that the decision was any less a management decision. It stated that “[i]ll-informed or ill-advised decisions taken in the management of a company remain management decisions”.¹³⁹⁴

It is submitted that it may be deduced from *Wood v Holden (Inspector of Taxes)* that in entities in which very few transactions take place (as was the case with Eulalia), that conducting those few transactions will be regarded as management of the company.¹³⁹⁵ Furthermore, that if the relevant management organs of an entity actually take the management decisions, their functions are not usurped. The mere influence of advisors, such as Price Waterhouse, will not be regarded as dictating to an entity which decisions they

¹³⁹³ *Wood v Holden (Inspector of Taxes)* [2006] EWCA Civ 26 1410.

¹³⁹⁴ *Wood v Holden (Inspector of Taxes)* [2006] EWCA Civ 26 1418.

¹³⁹⁵ The majority in *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 stated at para 68 that “*Wood v Holden* reminds us that special vehicle companies (or, no doubt, special vehicle boards of trustees) which undertake very limited activities are not necessarily shorn of independent existence; indeed they would be ineffective for the purpose devised if they were”.

ought to make. It is submitted that these conclusions will apply equally in determining the POEM of an entity as the court strongly suggested that the tests for POEM and central management and control are the same.

In the *Smallwood* case, the court held that if the POEM of the trust company (PMIL) had to be determined, the test in *Wood v Holden (Inspector of Taxes)* would have been appropriate. However, it was the POEM of the trustee(s), as a continuing body, that had to be determined. According to the court, the tax scheme was conceived in the United Kingdom by Mr Smallwood and his advisors and the different steps in the scheme were co-ordinated from the United Kingdom by the advisors. An integral part of the scheme was the exportation of the trust for a short period to Mauritius, only for it to be returned to the United Kingdom before the end of the tax year. The court therefore held that

“[t]here was a scheme of management of this trust which went above and beyond the day to day management exercised by the trustees for the time being, and the control of it was located in the United Kingdom.”¹³⁹⁶

The court in *Smallwood* therefore clearly indicated that, in determining POEM, a higher level of management than day-to-day management should be used.

In *Laerstate BV v HMRC*¹³⁹⁷ the United Kingdom court found that the relevant company's central management and control was in the United Kingdom. It therefore had to consider the DTT between the United Kingdom and the Netherlands. Regarding the meaning of POEM, the court quoted with approval a passage from the decision by the Special Commissioners in the *Smallwood* case and concluded that, having regard to the ordinary meaning of the words in their context and in the light of their object and purpose, the issue of POEM was approached as considering in which state the real management of the company is found.¹³⁹⁸ The court found that the activities of one of the directors of the company, Mr Bock, were concerned with policy, strategic and management matters and that it therefore constituted the real top level management (or the realistic positive management) of the company. The other director, Mr Trapman, conducted only activities such as signing documents when told to do so and routine matters such as the accounts. Hence the court held that the POEM of the company was where Mr Bock's activities took place, which was in London.¹³⁹⁹

In two South African cases, *Oceanic Trust*¹⁴⁰⁰ and *Tradehold*,¹⁴⁰¹ the courts pronounced on the meaning of POEM, but in a domestic law context. It was argued above that the meaning of the term in domestic law is the same as the meaning of the term used in DTTs and on that basis these two decisions may still be useful in ascertaining the meaning of the term POEM in article 4(3).

¹³⁹⁶ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 para 70.

¹³⁹⁷ *Laerstate BV v HMRC* [2009] UKFIT 209 (TC).

¹³⁹⁸ *Laerstate BV v HMRC* [2009] UKFIT 209 (TC) para 48.

¹³⁹⁹ *Laerstate BV v HMRC* [2009] UKFIT 209 (TC) para 50.

¹⁴⁰⁰ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127.

¹⁴⁰¹ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

In deciding the meaning of the term POEM, the court in *Oceanic Trust*¹⁴⁰² applied the test laid down by the Special Commissioners in the United Kingdom case of *Smallwood*.¹⁴⁰³ This test, the court found, was as follows.¹⁴⁰⁴ The POEM is the place where key *management and commercial decisions* that are necessary for the conduct of the entities business are in substance made. The POEM will *ordinarily* be the place where the most senior group of persons (for example, a board of directors) makes its decision, where *the actions to be taken* by the entity as a whole are determined. However, no definite rule can be given and all relevant facts and circumstances must be examined to determine the POEM of an entity. There may be more than one place of management, but only one POEM at any one time.

Regarding *Tradehold*,¹⁴⁰⁵ it will be recalled that Tradehold was an investment holding company incorporated in South Africa. Tradehold's board resolved at a meeting in Luxembourg that all future board meetings would take place in Luxembourg. The court held that "[t]his had the effect that, as from [the date of the board meeting], Tradehold became effectively managed in Luxembourg".¹⁴⁰⁶

From the case law it may be deduced that an entity is effectively managed by the highest level of management, that is, the place where the "shots are called", or where the top level of management is exercised.¹⁴⁰⁷ Usually, this level of management will be exercised by the board of directors in the case of a company, or by the trustees in the case of a trust. If, however, the top level management of an entity is usurped by another or if another person dictates to the board or the trustees what its decisions should be, it is that other person and not the board or the trustees that exercises effective management of the entity.

6.4.3.3 General remarks regarding the meaning of POEM in the OECD MTC

This part of the dissertation revisits a number of the cases that have already been discussed. Some repetition will therefore be inevitable. However, the relevant decisions are discussed again because they are also pertinent to this particular topic and any comments on them on the point must be made in the proper context.

One of the main questions surrounding POEM is whether it should have a special meaning,¹⁴⁰⁸ a particular treaty meaning or a domestic law meaning, in accordance with article 3(2) of the OECD MTC.¹⁴⁰⁹ According to Harris and Oliver "[t]he Commentary to Article 4(3) might suggest a special treaty meaning but it is so qualified that this is not clear".¹⁴¹⁰

¹⁴⁰² *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127.

¹⁴⁰³ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778. This case is discussed in greater detail in ch 6.4.4.

¹⁴⁰⁴ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127 para 54.

¹⁴⁰⁵ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

¹⁴⁰⁶ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para 3.

¹⁴⁰⁷ *Wood v Holden (Inspector of Taxes)* [2006] EWCA Civ 26; *Wensleydale's Settlement Trustees v IRC* [1996] STC (SCD) 241; *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA); *Laerstate BV v HMRC* [2009] UKFIT 209 (TC); *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127.

¹⁴⁰⁸ The Vienna Convention on the Law of Treaties 1969 art 31(4) provides that "[a] special meaning shall be given to a term if it is established that the parties so intended". See also ch 4.3.

¹⁴⁰⁹ Harris and Oliver *International Commercial Tax* 66. Regarding art 3(2) of the OECD MTC, see ch 5.2.6.

¹⁴¹⁰ Harris and Oliver *International Commercial Tax* 66.

Vogel states that the term POEM must be interpreted “autonomously”.¹⁴¹¹ Hattingh also supports the use of a “common international meaning”.¹⁴¹²

A further question relating to the meaning of POEM, is whether it has the same meaning as the term “central management and control”. Until 1988 and for United Kingdom domestic law purposes, a company’s residence was determined in accordance with the common law test of central management and control.¹⁴¹³ The test was first expounded in the case of *De Beers Consolidated Mines Ltd v Howe*¹⁴¹⁴ and has been consistently applied since then. The test centres on the highest level of decision-making¹⁴¹⁵ and was originally formulated as follows:

“In applying the conception of residence to a company, we ought, I think, to proceed as nearly as we can upon the analogy of an individual. A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business. ... [A] company resides for purposes of income tax where its real business is carried on I regard that as the true rule, and the real business is carried on where the central management and control actually abides.”¹⁴¹⁶

In *Wood v Holden (Inspector of Taxes)* the court expressed the following view:

“It is not clear – at least, not clear to me – whether the article 4(3) test differs in substance from the De Beers test; and, if the two tests are not, in substance, the same, I find it very difficult to see how, in the circumstances which the commissioners had to consider, they could lead to different answers.”¹⁴¹⁷

In that case, the court did not make a finding on where the POEM of the relevant company was. The case was decided on the central management and control test, but the court, in effect, stated that it would have reached the same conclusion if the POEM test were applied. Even before that case was decided, some authors argued that POEM and central management are identical.¹⁴¹⁸

Some authors, however, opine that central management and control is not the same as POEM. According to Harris and Oliver the two tests have different purposes and scope of operation.¹⁴¹⁹ Regarding the purpose of POEM, Harris and Oliver refers to the passage in the judgement of the Special Commissioners in *Smallwood*, where they stated:

¹⁴¹¹ Vogel *et al Klaus Vogel on Double Taxation Conventions* 262. It is understood that “autonomous” meaning connotes the meaning of the treaty irrespective of the domestic law of the relevant states. See ch 4.3.1.

¹⁴¹² Hattingh in *Residence of Companies under Tax Treaties and EC Tax Law* 730.

¹⁴¹³ The statutory test for residence is now contained in the Corporation Tax Act 2009 pt 2 ch 3 and provides that a company that is incorporated in the United Kingdom is deemed to be a resident there for purposes of that Act. Therefore, the central management and control test is no longer relevant for United Kingdom incorporated companies (Schwarz Booth & Schwarz: *Residence, Domicile and UK Taxation* 139).

¹⁴¹⁴ *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455 (HL).

¹⁴¹⁵ Harris and Oliver *International Commercial Tax* 60.

¹⁴¹⁶ *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455 (HL) 458.

¹⁴¹⁷ *Wood v Holden (Inspector of Taxes)* [2006] EWCA Civ 26 1396.

¹⁴¹⁸ Owen (2003) 4 BTR 296 305. Hattingh agrees, although his contribution was written after *Wood*’s case (Hattingh in *Residence of Companies under Tax Treaties and EC Tax Law* para 19.4.5.6).

¹⁴¹⁹ Harris and Oliver *International Commercial Tax* 67.

“[T]he two concepts serve entirely different purposes. CMC determines whether a company is resident in the United Kingdom or not; POEM is a tie-breaker the purpose of which is to resolve cases of dual residence by determining in which of two states it is to be found. CMC is essentially a one-country test; the purpose is not to decide where residence is situated, but whether or not it is situated in the United Kingdom ... POEM, on the other hand, must be concerned with what happens in both states since its purpose is to resolve residence under domestic law in both states, caused for whatever reason, which could include incorporation in one state and management in the other, or different meanings of management applied in each state, or different interpretations of the same meaning of management applied in each state, or divided management.”¹⁴²⁰

The Court of Appeal in the *Smallwood* case was concerned only with the POEM of the relevant trust. In its minority judgement the court acknowledged that the purpose of the POEM test is effectively to decide between two rival claims to tax based on residence. However, it continued by confirming that the test adopted by the Court of Appeal in *Wood v Holden (Inspector of Taxes)* to determine where central management and control was exercised, was the correct one, also for the facts before it.¹⁴²¹ It is submitted that this minority judgement of the Court of Appeal confirmed the dictum in *Wood v Holden (Inspector of Taxes)* that central management and control and POEM are not easily distinguishable (even though the two tests may have different purposes).

Regarding the scope of POEM, Harris and Oliver’s view is that a corporation may be centrally managed and controlled in more than one place. On the other hand, POEM of an entity can only be in one place.¹⁴²² They also state that the tax administration in the United Kingdom accepts that the two tests do not necessarily correspond: central management and control focuses on where strategic decisions are made, while POEM focuses on where the top-level decisions are formulated.¹⁴²³

According to Panayi the tests of central management and control and POEM are similar, but not identical, and they fulfil different functions. She suggests that the onus of proof required to satisfy each test may differ.¹⁴²⁴

6.4.4 Who exercises the effective management of a trust?

In all of the jurisdictions considered in this dissertation, the management of the trust is in the hands of the trustees.¹⁴²⁵ It should therefore follow that the POEM of a trust is, generally, exercised by its trustees. There may, however, be cases where a person other than the trustee, such as the settlor or a beneficiary, exercises the effective management of a trust.

¹⁴²⁰ *Trevor Smallwood Trust v The Commissioners for Her Majesty's Revenue and Customs* (2008) Sp C 669 paras 111 and 112. This approach was confirmed in *Laerstate BV v HMRC* [2009] UKFIT 209 (TC) para 48.

¹⁴²¹ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 para 61.

¹⁴²² Commentary on the OECD MTC art 4(3) para 24.

¹⁴²³ Harris and Oliver *International Commercial Tax* 67.

¹⁴²⁴ Panayi in *Residence of Companies under Tax Treaties and EC Law* 848.

¹⁴²⁵ See ch 2.7. In ch 2 the term “administration” was used to refer to the conduct of the trust’s affairs. In this paragraph the term “management” is used in order to conform with the words used in the case law cited. It is intended that the terms “management” and “administration”, as used in ch 2, should have the same meaning.

In the United Kingdom case of *Wensleydale's Settlement Trustees v Inland Revenue Commissioners*¹⁴²⁶ a settlor wished to set up an *inter vivos* trust in Ireland. The trustees were the settlor's solicitor in England and the wife of a solicitor in Ireland. At issue in the case was whether a capital gain on the sale of shares could be taxed in the United Kingdom. The trustees of the trust (who were regarded in terms of United Kingdom legislation as a continuing body of persons and resident in the United Kingdom) argued that, for purposes of the DTT between the United Kingdom and Ireland, the trustees were resident only in Ireland, since the POEM of the trust was in Ireland. If they were correct, only Ireland could tax the relevant gain. The court found that the opening of the bank account did not constitute effective management. Even though the trustees took a resolution in Ireland to sell certain shares, the court held that the trustees were "handed property the disposal of which was being arranged in England" and that it was "unreal to suppose that they could reject the offer".¹⁴²⁷ Furthermore, the court found that the one trustee, the Irish solicitor's wife, was "a trustee in name, rather than in reality".¹⁴²⁸ Moreover, the trustees were often pushed by the settlor to do what the settlor wanted them to do. On these facts, the court found that the POEM of the trust was not in Ireland.¹⁴²⁹

In the *Smallwood* case in the United Kingdom, the majority of the court held that the tax scheme in question was designed by Mr Smallwood and his advisors in the United Kingdom, and that they carefully co-ordinated every step of the implementation of the scheme from the United Kingdom.¹⁴³⁰ The whole scheme was based on the fact that the trust would be temporarily exported to Mauritius and then returned to the United Kingdom for a brief period. This led the court to the conclusion that the POEM of the trustee, as a continuing body, was in the United Kingdom.¹⁴³¹ It can also be deduced that in the case of a trust, it is possible for a person other than the trustees to effectively manage a trust, although the court did not indicate on what basis this was possible.¹⁴³²

¹⁴²⁶ *Wensleydale's Settlement Trustees v IRC* [1996] STC (SCD) 241.

¹⁴²⁷ *Wensleydale's Settlement Trustees v IRC* [1996] STC (SCD) 241 para 7(2).

¹⁴²⁸ *Wensleydale's Settlement Trustees v IRC* [1996] STC (SCD) 241 para 7(2).

¹⁴²⁹ For criticism on this case, see Zigmond (1996) 5 *Untelrab and Wensleydale: Reflections on Company and Trust Residence* 316.

¹⁴³⁰ Much criticism has been expressed against the case. See eg Lawrence (2011) 2 *Smallwood: Part 2 – Poetic Justice?* 77; Goldberg (2009) VIII *GITC Review* 1, Loomer (2009) 4 *BTR* 378 and Grundy (2008) VII *GITC Review* 1.

¹⁴³¹ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 para 70.

¹⁴³² Hattingh criticises the Special Commissioners' decision on this point, but it is submitted that this criticism would equally apply to the decision by the Court of Appeal. He suggests that it should have been decided whether the Mauritian trustee was merely a pretence for KPMG and Mr Smallwood, who, *de facto*, exercised the powers of the trustees. In other words, the court should have asked whether Mr Smallwood and his advisors usurped the Mauritian trustee's trusteeship. According to Hattingh the substance over form doctrine in South Africa is the appropriate legal basis to deal with such a simulation. As Hattingh correctly points out, the court in *Smallwood* found that all the relevant agreements were in fact what they purported to be and that there was no simulation. Hence the doctrine of substance over form cannot (at least in *Smallwood*) provide the basis for finding that someone other than the trustees managed the trust. Much uncertainty is created by the court's failure to provide a legal basis for its conclusion (Hattingh in *Residence of Companies under Tax Treaties and EC Tax Law* 748). Other courts have also suggested that the substance over form doctrine may be used in situations where a person other than the trustee has exercised the trustees' powers. In *Garron* the Tax Court of Canada held that there was an unwritten agreement that the trustee would comply with the recommendations of the main beneficiaries and that the main beneficiaries understood this from the outset. This unwritten agreement was enforceable through the mechanism of a protector, who was entitled to replace the trustee (*Garron v R* 2009 TCC 450; 12 ITLR 79). It is submitted that the Tax Court's decision that there was an unwritten

Importantly, the court seemed to accept (as did the Special Commissioners) that the day-to-day management of the trust was exercised properly by the Mauritian trustee and that the Mauritian trustee took proper decisions when selling the relevant shares. It is submitted that the decision in *Smallwood* conflicts with that in *Wood v Holden (Inspector of Taxes)*. As explained more fully above, in *Wood v Holden (Inspector of Taxes)* the court urged a distinction between cases where the management of a company was completely usurped (that is, the board took no decisions and was completely sidestepped) and those in which the management was properly exercised by the company's constitutional organs. In the case where the management was properly exercised, a further distinction had to be made, namely between influence on decisions and dictating of decisions.¹⁴³³ Where a company's management is usurped, or its decisions, although taken by its board, are dictated by another, it is not the board exercising the central management and control of the company. On the facts the court held, *inter alia*, that the directors of Eulalia were not bypassed – ABN AMRO did indeed make a decision to enter into the agreements of sale and purchase – and that Price Waterhouse did not dictate to ABM AMRO which decisions they were to make, although their influence was acknowledged. In *Smallwood*, the court acknowledged that PMIL took valid decisions to sell the shares in question. Therefore, as in *Wood*, the trustee's management was not usurped. Furthermore, it is doubtful whether the advisers in *Smallwood* dictated to PMIL what their decisions as trustees ought to have been.

The majority in *Smallwood* tried to explain that the test in *Wood* was inappropriate because it was the POEM of the trustees as a continuing body that had to be determined and not the POEM of the trust company trustee (PMIL).¹⁴³⁴ It is submitted that this explanation is unconvincing.¹⁴³⁵ Why can the test in *Wood* not be applied to the management of the trust by the trustee? In all of the jurisdictions considered in this dissertation, the management of the trust is in the hands of the trustees. It will therefore be possible to establish whether the trustees have been sidestepped altogether, thereby usurping the trustees' management of the trust. Whether advisors merely influenced the decision of the trustees in managing the trust, or whether advisors dictated to the trustees what their decisions should be, is a question of fact and can be ascertained in the same way as in the case of a company. In this regard the distinction drawn by Cleave between the different levels of residence of a corporate trustee seems helpful:

“The residence of a corporate trustee carrying on business as trustee of a number of different trusts has to be considered on two levels. At the level of deciding whether to accept appointment in any particular trust and at what rate of remuneration and so forth, it is likely to have its central management and control in the state where it is registered and carries on business. On the other hand, in relation to the administration

(but enforceable) agreement, suggests that the court applied the doctrine of substance over form. This point was not addressed by the Supreme Court of Canada in the appeal of the *Garron* case. The possibility of using the doctrine of substance over form (or perhaps, more correctly, the sham doctrine) to explain the result in *Smallwood*, *Garron* and even *Oceanic Trust* is an interesting idea and requires further research and analysis. One could even consider the possibility of “sham trusts” and the abuse of the trust form. However, these matters fall outside the scope of this dissertation.

¹⁴³³ *Wood v Holden (Inspector of Taxes)* [2006] EWCA Civ 26 1410.

¹⁴³⁴ *Commissioners for Her Majesty's Revenue and Customs v Smallwood* [2010] EWCA Civ 778 para 69.

¹⁴³⁵ For further criticism of this part of the judgement, see Cleave (2011) 6 *BTR* 705 714.

and decision-making in respect of particular transactions in the context of particular trusts, the answer may be quite different.”¹⁴³⁶

It is submitted that it is the second level referred to by Cleave, namely the management and decision-making in respect of a specific trust, that is relevant in determining the POEM of the trust (or the trustees as a continuing body) and that the test laid down in *Wood* can (and should) be applied to it.

The decision in the South African *Oceanic Trust* case may be repeated briefly. The trust, SIMS, was established and registered in Mauritius and the law of Mauritius was to govern the administration of the settlement. The trustees were obliged to maintain their principal place of business at, and conduct their affairs from, premises in Mauritius. Its sole trustee was the Oceanic Trust Co Ltd, a company registered and incorporated in Mauritius. SIMS acted as captive reinsurer to MCubed Life Ltd, a South African registered company (and it is assumed, also a South African resident for tax purposes). The court adopted the test for POEM as set out in the Special Commissioners’ decision in *Smallwood*. On the facts before it, the court held that at least some of the key management decisions and at the very least some of the key commercial decisions necessary for the conduct of SIMS’s business were in substance made in South Africa.¹⁴³⁷

By implication, the court held that SIMS’s trustee (the Oceanic Trust Co Ltd) did not make all the key management and commercial decisions that were necessary for the conduct of SIMS’s business.¹⁴³⁸ It was common cause that SIMS’s trustee, the Oceanic Trust Co Ltd, had no links to South Africa and that its director had never been to South Africa. If some of its key management and commercial decisions were made in South Africa, these could not have been made by the trustee. The court gave no indication of the basis on which these decisions were taken by a person other than the trustee and made no finding as to whom, in fact, made these decisions.

In *Fundy Settlement v Canada*¹⁴³⁹ the Supreme Court of Canada pronounced on the residence test of a trust for domestic law purposes and chose the central management and control test. Even though that case dealt with domestic law and central management and control, it is submitted that the case may still shed light on the question of who manages the trust for purposes of POEM in DTTs.¹⁴⁴⁰ On the facts in *Fundy Settlement* the court held that the trusts were resident in Canada, where its central management and control was exercised by the main beneficiaries. The trustee had a restricted role, namely to provide administrative services, and had limited responsibility beyond that.¹⁴⁴¹

¹⁴³⁶ Cleave (2011) 6 BTR 705 713.

¹⁴³⁷ The facts on which the court reached this decision were set out above.

¹⁴³⁸ Support for this view may be found in Muller *Determining the Residence of a Trust: a South African Income Tax Perspective* 257.

¹⁴³⁹ *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520.

¹⁴⁴⁰ On the basis of the finding in *Wood v Holden (Inspector of Taxes)* [2006] EWCA Civ 26 it is difficult to see how the two tests differ and, if they differ, whether they would lead to different results in a given set of facts.

¹⁴⁴¹ *Fundy Settlement v Canada* 2012 SCC 14, [2012] 1 SCR 520 para 15. The facts which led the court to this conclusion are set out in an earlier paragraph.

In all of the cases referred to in this paragraph, the courts found that the effective management¹⁴⁴² of the trust was in the hands of persons other than the trustee. However, in all of the jurisdictions under discussion, only the trustees may manage a trust. How is it possible for the courts to find that effective management of the trust is in the hands of someone else than the trustee? The facts in the *Oceanic Trust* case may be used to illustrate this point. In that case the administration of the trust was governed by Mauritian law and one would assume that that law would apply to determine whether persons other than the trustee could make these kinds of decisions.¹⁴⁴³ Assume, however, that the facts are the same and that South African trust law applies. As argued earlier,¹⁴⁴⁴ in terms of South African law only the trustees of a trust may make the fundamental decisions regarding the trust. If the trustees were to abdicate their responsibility to take these types of decisions, the actions of the person who purported to act on behalf of the trust would be invalid. It is submitted that “key management and commercial decisions that [are] necessary for the conduct of SIMS’s business” would be regarded as fundamental decisions, which only the trustees could make. The trustees would therefore have been unable to delegate authority to the asset manager (or another person) to take these decisions and such delegation and subsequent actions would be invalid.¹⁴⁴⁵

The answer to the problem stated above may be found in an analogy with a similar problem found in company law cases. In these cases, the company may only act through certain organs, typically the board of directors. In *Unit Construction Co Ltd v Bullock (Inspector of Taxes)*¹⁴⁴⁶ the taxpayer was a wholly-owned subsidiary of a United Kingdom company. The taxpayer and three other co-subsiary companies were incorporated in Kenya and the taxpayer made certain payments to the co-subsiaries which it claimed as a deduction for tax purposes. The deduction could only be claimed if the co-subsiaries were resident in the United Kingdom and carried on a trade wholly or partly in the United Kingdom. The management of the subsidiary companies was placed in the hands of their respective directors and, in terms of their articles of association, meetings of their boards of directors could only take place outside of the United Kingdom. However, these organs did not exercise central management and control of the relevant companies. Instead, central management and control of the subsidiaries was exercised by the board of the holding company in London, since the court found that the subsidiaries’ boards stood aside in both important and less important decisions and never purported to function as a board. Since management of the subsidiaries had been usurped by the holding company, it followed, so the court held, that the subsidiaries’ businesses were conducted “in a manner irregular, unauthorised and perhaps unlawful”.¹⁴⁴⁷ The court held that it does not matter that the acts which prove that central management and control of the subsidiaries was in London, are irregular, unauthorised or unlawful. The court stated that the residence of the subsidiaries was

¹⁴⁴² Or in some cases the central management and control.

¹⁴⁴³ See *Commissioner for Inland Revenue v Estate Greenacre* 1936 NPD 225; 8 SATC 196 and a discussion of this case in ch 2.2.3. A discussion of Mauritian trust law falls outside the scope of this dissertation.

¹⁴⁴⁴ See ch 2.2.6.

¹⁴⁴⁵ This argument applies the “second approach” referred to by Gutuza, namely scrutinising the trust deed and trust law to determine the person that is empowered to effectively manage the trust in terms of its rules (Gutuza (2012) 24 SA Merc LJ 424 428).

¹⁴⁴⁶ *Unit Construction Co Ltd v Bullock (Inspector of Taxes)* [1960] AC 351 (HL).

¹⁴⁴⁷ *Unit Construction Co Ltd v Bullock (Inspector of Taxes)* [1960] AC 351 (HL) 362.

determined by the solid facts, not by the terms of their constitutions, however imperative these may be.¹⁴⁴⁸

It may therefore be argued that, similar to companies, trusts that are managed by persons who are not authorised to do so, such as beneficiaries, settlors or advisors, will be held to be effectively managed by these persons. Therefore, even if trust instruments and trust law place the management of the trust in the hands of the trustee only and cause management acts exercised by another person to be void, these rules will not bar a court from holding that these persons actually exercised effective management of the trust.

In conclusion, the case law reveals that often persons other than the trustees are held to be effectively managing a trust. It is submitted that the test laid down in *Wood v Holden (Inspector of Taxes)* which outlines the circumstances under which it will be held that a board of directors are not effectively managing a company, can and should be applied by analogy to trustees managing a trust. Adapting the test for trusts, it is submitted that a distinction should be made between (a) cases where effective management of the trust is exercised by its trustees, and (b) cases where the functions of the trustees are usurped, in the sense that management is exercised independently of, or without regard to, the trustees. In cases which fall within item (a), it is essential to recognise the distinction (in concept, at least) between (i) the role of an “outsider” in proposing, advising and influencing the decisions which the trustees take in fulfilling their functions, and (ii) the role of an outsider who dictates the decisions which are to be taken. In that context an “outsider” is a person who is not himself or herself a participant in the formal process (for example, a meeting of trustees) through which the trustees fulfil their function. Further guidance from *Wood’s* case should also be borne in mind. If only a few transactions are undertaken by the trustees, the conclusion of those transactions will constitute the management of the trust by the trustees; and even if decisions are taken by the trustees without full and detailed information available to them, these are still valid trustee decisions and the functions of the trustees have not been usurped.

In *Wensleydale, Smallwood and Fundy Settlement* the trustees did indeed take the relevant decision and it cannot therefore be argued that these cases could fall within item (b) above, namely that the functions of the trustees were usurped. It may possibly be argued that *Oceanic Trust* falls within item (b), as the court, by implication, held that a person other than the trustee made some of the key management and commercial decisions. It must, however, be borne in mind that in that case very limited relief was applied for. The court did not pronounce on the merits of the assessment or the taxpayer’s objection. If, however, one accepts that persons other than the trustees took key management and commercial decisions for the trust, it is an example of a case where the trustees’ functions are usurped and where the effective management of the trust is not in the hands of the trustees, but in the hands of the “usurper”. As argued above, the fact that the “usurper’s” management of the trust may be irregular, unauthorised and perhaps unlawful, is irrelevant.

Save for (possibly) *Oceanic Trust*, the other cases mentioned in this paragraph all fall within item (a) above, namely where effective management was exercised by the trustees. The

¹⁴⁴⁸ *Unit Construction Co Ltd v Bullock (Inspector of Taxes)* [1960] AC 351 (HL) 363.

question then arises whether the relevant outsiders in each case (i) influenced or (ii) dictated the trustees' decision.

It is submitted that *Wensleydale* and *Fundy Settlement* fall within item (ii). In *Wensleydale* it was held that the settlor often pushed the trustees to do what he wanted them to do and that the one trustee was a trustee in name only, merely doing what she was told to do. In *Fundy Settlement*, the court found that there was an unwritten agreement that the trustee would comply with the recommendations of the main beneficiaries and that the unwritten agreement was enforceable through the mechanism of a protector. These cases therefore illustrate the point that where an outsider dictates to the trustees what their decisions should be, the trust is effectively managed by the outsider, and not by the trustees.

It is submitted that the *Smallwood* case falls within item (i) and that in that case the advisors and settlor merely influenced the trustees' decision and did not dictate to them. It is therefore submitted that the *Smallwood* case was decided wrongly on the facts. It is submitted that South African courts should follow the test set out above (which is based on the test laid down in *Wood*) in deciding who exercises the POEM of a trust.

One final point should be made regarding the involvement of the settlor in the management of a trust in South Africa. It was argued earlier that where the trustees are subject to an unacceptable degree of control by the settlor, it may well indicate that the settlor never had the intention to create a trust in the first place, resulting in the invalidity of the trust.¹⁴⁴⁹ If the trust is held to be invalid, it will have to be determined whether there is still a "trust" as defined in the Income Tax Act,¹⁴⁵⁰ which can be regarded as a taxpayer and therefore a person for purposes of the relevant DTT.

6.5 Conclusion

6.5.1 General

In order to qualify for the benefits of a DTT, a trust(ee) has to be regarded as a resident. Residency is also pertinent in the application of the distributive articles of the DTT.

Article 4 of the OECD MTC determines residence for purposes of the DTT. This article requires, *inter alia*, that domestic law be applied to establish whether a person is liable to tax by reason of certain factors. The liable to tax requirement in article 4(1) is riddled with interpretational difficulties. A point that is clear, though, is that the OECD MTC does not require a resident of a state to be liable to tax on a specific item of income in order to claim treaty benefits regarding that income. As long as there is a general liability to tax and the person derives or receives income, the treaty will be applied, regardless of whether the person is actually taxed on that specific item of income. Who is the person whose liability to tax must be determined? By examining domestic law, it was concluded that in South Africa and Canada, the relevant person is the trust itself. In the United Kingdom, it is the trustees (as a body of persons) who are liable to tax.

¹⁴⁴⁹ See ch 2.2.6.

¹⁴⁵⁰ Income Tax Act 58 of 1962 s 1.

6.5.2 Transparency and the “liable to tax” requirement

Regarding transparency, guidance may be sought from the OECD Partnership Report (the other OECD Reports not being particularly helpful). It is generally accepted that if a state treats an entity as fiscally transparent, it is not liable to tax in that state and can therefore not be regarded as a resident of that state. There are different degrees of transparency and the degree of transparency influences whether an entity will be regarded as liable to tax (and therefore resident). Trusts that are completely transparent, or that are transparent, but have only reporting requirements, are not regarded as liable to tax. Thus, for example, in South Africa, vesting trusts and, in the United Kingdom and Canada, bare trusts, are completely transparent. Therefore in South Africa and Canada these trusts (and in the United Kingdom, the trustees of such a trust) will not be regarded as liable to tax and resident in the respective countries.

More problematic are those entities that can be classified as partially transparent. Academic authors have differing views regarding the application of the liable to tax requirement to partially transparent entities. According to Easson, partially transparent trusts that are taxed on their undistributed income will not be treated as transparent. This will be the case even when the trust distributes all of its income during a particular year. According to Baker, trusts that are taxed on undistributed income would be liable to tax in relation to that income. In relation to the income that is taxed in the hands of the beneficiaries only, the beneficiaries would be entitled to the benefits of the DTT. According to Lang, it is irrelevant that a trust is (partially) transparent; as long as there is a close enough connection to the particular state, it will be considered a resident there. Lang’s view is not supported by the majority of academic authors or the Partnership Report and is contrary to case law. It is therefore submitted that it should not be supported. The views of Edwardes-Ker and Koele are also criticised and can thus likewise not be supported.

Examining the domestic law provisions of the relevant states regarding trusts, it was found that in South Africa in respect of trust income that is taxed in the hands of the trust, the trust will be regarded as liable to tax. In respect of income that is not retained in the trust, but distributed to the beneficiary and taxed at that level, it is arguable that a trust should not be regarded as liable to tax. However, since a trust need not be liable to tax on a specific item of income in order to claim treaty benefits regarding that income, it is submitted that a trust that is regarded as liable to tax on certain undistributed income, will also be regarded as liable to tax on all its undistributed income. In the case of a discretionary trust, it is submitted that the trust is, arguably, also liable to tax in those years in which all of its income is distributed. In the United Kingdom it seems clear that the trustees are liable to tax for purposes of article 4(1) of the OECD MTC. In Canada the trust will be regarded as liable to tax.

Considering all of the views and the domestic tax law of the relevant states, it is submitted the more practical solution is that a trust that is taxed on undistributed income will be liable to tax in relation to that income. Regarding that portion of the income which is taxed in the hands of the beneficiaries, the beneficiaries resident in the relevant countries would be entitled to the benefits of the applicable conventions, to the extent that they are liable to tax on the income distributed to them.

If the income of a trust(ee) is deemed by legislation to be that of another person, it is submitted that such an attribution is ignored in determining whether the trust(ee) is liable to tax for purposes of article 4(1).

6.5.3 The requirement “by reason of” certain criteria

The words of article 4(1) “by reason of his domicile, residence, place of management or any other criteria of a similar nature” mean that there must be a causal relationship or some form of proximity between the grounds for taxation in a particular state and the listed criteria in article 4(1). The listed criteria furthermore connote comprehensive liability imposed by a state and any basis of taxation which is to be classified as a “criterion of a similar nature” should also involve comprehensive liability.

6.5.4 Domestic law

Because article 4(1) requires that the domestic law of the relevant state be applied, it was necessary to examine the laws of the applicable states that determine the residence of a trust. In South Africa a trust may be a resident because it was established or formed in South Africa, or because it has its POEM in South Africa. If, however, a trust is deemed to be a resident of another state because of the application of a DTT, it will not be regarded a resident for South African domestic law purposes. Regarding the first criterion, the preferred interpretation of the phrase “established or formed in South Africa” is “within South Africa’s borders”, but it is recommended that the legislature should clarify this by legislative amendment. Since *inter vivos* trusts are formed by way of a contract, the normal rules regarding the time and place where the contract is formed, will determine where the trust is formed. However, the parties may specify in their agreement when and where it will come into being, in which case the normal rules will not apply. The ECTA sets out the rules for the formation of agreements concluded by way of a data message. Thus trusts formed, for example, by way of e-mail messages, will be formed at the place and time as set out in that Act. Once again, however, the parties may stipulate in their agreement where the trust will be formed and then the provisions of ECTA will not apply. Testamentary trusts are formed at the place where the testator executes the will through which the trust is formed. Since a trust is not established or formed through the registration of the trust instrument, or the authorisation of the trustees by the Master, these formal acts by the Master are irrelevant in determining a trust’s residence. From the rules set out above, it is clear that the place of formation of a trust may be easily manipulated, or may be determined arbitrarily. A possible solution would be to amend the legislation to provide that a trust will be resident in South Africa if registration of the trust instrument and authorisation of trustees are required in terms of the Trust Property Control Act. However, oral trusts, which are not covered by the Act, would be excluded from such a solution.

Trusts may also be resident in South Africa if their POEM is in South Africa. It is submitted that the term POEM in the South African Income Tax Act should take its meaning from the term POEM in South Africa’s DTTs. SARS’s view regarding the meaning of the term POEM, which focuses on the place where decisions are implemented and also on a lower level of management as set out in their Interpretation Note, is not followed in the case law. It is submitted that the POEM of a trust will be where the highest level of management is

exercised, which will usually be where the trustees take their decisions (although this will not always be the case).

In the United Kingdom, the residence of trustees (as a body) is determined by legislation. If all the trustees are resident in the United Kingdom, the trustees (as a body) will be resident in the United Kingdom. If at least one trustee is a United Kingdom resident and at least one trustee is not a United Kingdom resident, the emphasis moves to the settlor. If in such a case certain conditions are met by the settlor, the trustees (as a body) will be regarded as resident in the United Kingdom.

In Canada, the residence of a trust is determined by the central management and control test. A trust can also be deemed to be a resident of Canada in terms of the Income Tax Act, but case law suggests that a trust would not be liable to tax by reason of its residence for purposes of the relevant treaty. However, recent legislation now provides that trusts deemed to be resident in Canada for income tax purposes will also be resident for DTT purposes.

In the Netherlands, very few trusts will be regarded as residents. A trust could be resident in the Netherlands if its POEM is in the Netherlands.

In all of the states under consideration, it is possible to change the trust's residence for domestic law purposes.

6.5.5 The tiebreaker: POEM

The tiebreaker provision of article 4 will be applied if both states regard the trust as resident in that state. After examining the OECD Commentary to article 4(3), the relevant case law and the opinions of academic authors, it was concluded that in all of the relevant states the tiebreaker in respect of persons other than individuals (that is, POEM) will be used in respect of trusts.

In terms of the *Smallwood* case, no distinction should be drawn between concurrent and consecutive periods of residence in cases where domestic legislation deems a person to be liable to tax for the whole year, even though a person was resident in that state for only part of the year. The judgement has been criticised in this regard.

Regarding the meaning of the term POEM, the OECD in 2008 amended its Commentary to article 4(3). The reference to the "most senior person or group of persons (for example a board of directors)" was deleted. The test formulated in the Commentary now simply refers to the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. The Commentary further states that all the relevant facts and circumstances must be examined to determine the POEM and that an entity can have only one POEM at a time. Case law in South Africa, the United Kingdom and Canada reveals that the courts regard an entity as effectively managed at the place where the highest level of management is exercised. Usually, this level of management is exercised by the trustees, but if the top level management of the trust is usurped by another or if another person dictates to the trustees what they should decide, it is that other person and not the trustees who exercises the effective management of the company. There are other uncertainties regarding the meaning of POEM. It is not clear

whether the term should have a special meaning, a particular treaty meaning or a domestic law meaning. Furthermore, there is no consensus on whether POEM and the central management and control test are the same. It is submitted that even though there might be some differences in the approach to the two tests, the tests will very often yield the same results on the facts of a particular case.

In order to determine where the POEM of a trust (or the trustees) is located, it has to be decided who the person is that exercises its effective management. In terms of trust law, it is the trustees who manage the affairs of the trust and one would expect them to exercise the effective management of the trust. An examination of the case law reveals, however, that persons other than the trustees are often held to exercise the effective management of the trust. In this regard, it is proposed that the test in *Wood v Holden (Inspector of Taxes)* be adapted as follows to apply to trusts. A distinction should be made between cases where the functions of the trustees are usurped and cases where the trustees effectively manage the trust. The trustees' functions will be usurped if a person other than the trustee exercises the management functions of the trustees, independently from them or without regard to them. If the trustees' management of the trust is usurped, the "usurper's" management of the trust will be irregular, unauthorised and perhaps unlawful. It is submitted, however, that this will be irrelevant in the determination of POEM. In cases where there is no usurpation, the effective management of the trust is exercised by the trustees. In such cases the influence of an outsider, such as an advisor, settlor or beneficiary, will not disturb the finding that the trustees exercise the effective management of the trust. If, however, the outsider dictates to the trustees what their decisions should be, it is the outsider, and not the trustees, who effectively manages the trust. It is furthermore submitted that the *Smallwood* case was decided incorrectly, in that on the facts of that case the outsiders did not usurp the functions of the trustees, nor did they dictate to the trustees the decisions that should have been taken.

6.5.6 The residence of a trust: the different states

Examining the residence of trusts for purposes of the OECD MTC on a country by country basis, the analysis reveals the following. In South Africa, it is the residence of the trust itself that has to be determined for purposes of article 4(1). Trusts that are completely transparent, or that are transparent, but have only reporting requirements (such as vesting trusts) will not be regarded as liable to tax. Examining the domestic law provisions regarding trusts in South Africa, it was concluded that in respect of trust income that is taxed in the hands of the trust, the trust will be regarded as liable to tax. In respect of income that is not retained in the trust, but distributed to the beneficiary, both the view that the trust is liable to tax and that it is not can be sustained. It is submitted that Baker's view is the most practical in the case of partly transparent entities and it is recommended that his view be applied in South Africa. In terms of South African domestic law, a trust may be a resident because it was established or formed in South Africa, or because it has its POEM in South Africa. If, however, a trust is deemed to be a resident of another state because of the application of a DTT, it will not be regarded a resident for South African domestic law purposes. Regarding the meaning of POEM, case law in South Africa suggests that the courts regard an entity as effectively managed at the place where the highest level of management is exercised. Usually this level of management is exercised by the trustees, but if the top level management of the trust is usurped by another or if another person dictates to the

trustees what they should decide, it is that other person and not the trustees who exercises the effective management of the trust. It is submitted that this test (as proposed in *Wood*) should be followed in South Africa to determine who exercises the effective management of a trust.

In the United Kingdom, it is the residence of the trustees (as a body) that has to be determined for purposes of article 4(1). Bare trusts are completely transparent and the trustees of such a trust will not be regarded as liable to tax and resident in the United Kingdom. It is clear that, in terms of the domestic law provisions regarding trusts in the United Kingdom, the trustees are liable to tax for purposes of article 4(1) of the OECD MTC. It is submitted that Baker's view is the most practical in the case of partly transparent entities and it is recommended that his view be applied in the United Kingdom. In terms of the United Kingdom domestic law provisions, the residence of trustees (as a body) is determined by legislation. If all the trustees are resident in the United Kingdom, the trustees (as a body) will be resident in the United Kingdom. If at least one trustee is a United Kingdom resident and at least one trustee is not a United Kingdom resident, the emphasis moves to the settlor. If in such a case certain conditions are met by the settlor, the trustees (as a body) will be regarded as resident in the United Kingdom. Regarding the meaning of POEM, case law in the United Kingdom is to the same effect as that in South Africa. It is submitted that the decision in *Smallwood* was incorrect on the facts of that case and that, as suggested, the test in *Wood* as adapted for trusts should be applied.

In Canada, it is the residence of the trust itself that has to be determined for purposes of article 4(1). In the case of bare trusts, which are completely transparent, these trusts will not be regarded as liable to tax and resident in Canada. Examining the domestic law pertaining to trusts in Canada, it is evident that the trust will be regarded as liable to tax. It is submitted that Baker's view is the most practical in the case of partly transparent entities and it is recommended that his view be applied in Canada. Domestic law provides that the residence of a trust is determined by the central management and control test. A trust can also be deemed to be a resident of Canada in terms of the Income Tax Act, but case law suggests that a trust would not be liable to tax by reason of its residence for purposes of the relevant treaty. Regarding the meaning of POEM, case law in Canada is to the same effect as that in South Africa and the United Kingdom.

Regarding the Netherlands, very few trusts (or trustees) will be regarded as resident in the Netherlands for domestic law purposes and, consequently, also for treaty purposes. If a trust(ee) can be resident in the Netherlands, the POEM test will be used to determine whether it is indeed resident in the Netherlands. Many trusts will also be regarded as APVs, which would mean that all the income of the trust will, generally speaking, be attributed to the settlor. Arguably, the attribution to the settlor will not influence the trust's (trustees') possible treaty residence.

6.5.7 Closing remarks

The question whether a trust is a resident for treaty purposes is a complex one, depending to a large extent on the domestic tax law treatment of the trust, but also on the facts surrounding the specific trust. Particularly the issue of partially transparent entities is complicated with divergent views being expressed on the topic. It is recommended that

South Africa create greater certainty in its tax treaties. This may be done by (a) including trusts in the definition of person; (b) including appropriate reservations in the Commentary; and (c) amending its domestic legislation in relation to trust residency.

CHAPTER 7

CONFLICTS OF ATTRIBUTION OF INCOME IN RELATION TO TRUSTS

Chapter overview	226
7.1 Introduction	227
7.2 Review of the attribution of trust income	229
7.2.1 South Africa	229
7.2.2 United Kingdom	230
7.2.3 Canada	230
7.2.4 The Netherlands	230
7.2.5 Conclusion	231
7.3 Examples	231
7.3.1 Income sourced in one state, but trust, trustee, beneficiaries and settlor resident in the other state	231
7.3.2 Income attributed to another	234
7.3.3 Other selected examples	235
7.4 Possible solutions to conflicts of attribution	237
7.4.1 Should conflicts of attribution be resolved?	237
7.4.2 Approach similar to that of the Partnership Report	238
7.4.3 Tiebreaker	240
7.4.4 Attribution according to source state	240
7.4.5 Autonomous attribution	241
7.4.6 Conclusion	241
7.5 Application of the approach similar to that of the Partnership Report to trusts	241
7.5.1 Income sourced in one state, trust, trustee, beneficiaries and settlor resident in the other state	241
7.5.2 Income attributed to another	243
7.5.3 Other selected examples	243
7.6 Conclusion	245

7.1 Introduction

Tax systems usually attribute income to a specific taxpayer. In other words, a specific item of income is linked to a specific taxpayer and taxed in his or her hands. Salom defines attribution as “the link between the subject and the object to be taxed”, but makes the point that a taxpayer to whom the income is attributed does not necessarily carry the tax burden.¹⁴⁵¹

Wheeler provides three reasons for attributing income to a person:

- (a) The person that is liable to tax in relation to the income must be identified.
- (b) The person who is entitled to claim treaty benefits in respect of the income must be identified.
- (c) The person entitled to the double taxation relief (whether domestic relief, or in terms of a Double Taxation Treaty (DTT)) must be identified.¹⁴⁵²

Therefore, as Wheeler states:

“[T]he attribution of income to a person is fundamental to the application of treaties; together with residence, it determines which treaty, if any, applies to an item of income.”¹⁴⁵³

The Organisation for Economic Co-operation and Development Model Tax Convention (OECD MTC) thus requires that there should be a connection between the item of income and a specific taxpayer.¹⁴⁵⁴ According to Salom, the attribution of income to the resident claiming the treaty benefits is one of the conditions that must be met before a DTT can be applied.¹⁴⁵⁵ The distributive articles of the OECD MTC use a variety of terms to denote the connection between an item of income and a person. For example, articles 10(1) and 11(1) use the term “paid to”, while articles 6(1) and 13(1) use the term “derived by”. Article 12 uses the term “beneficially owned” and article 7(1) uses the term “profits of”.¹⁴⁵⁶ It is this language used by the distributive rules that provides the requirement of the connection between the item of income and the taxpayer.¹⁴⁵⁷

¹⁴⁵¹ Salom (2011) 65 *BFIT* 394 394.

¹⁴⁵² Wheeler in *Cahiers de Droit Fiscal International: Conflicts in the Attribution of Income to a Person* 19.

¹⁴⁵³ Wheeler (2005) 59 *BFIT* 477 477; Danon (2014) 68 *BFIT* 1 3.

¹⁴⁵⁴ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 296; Wheeler (2011) 3 *World Tax Journal* 247 255; Danon (2014) 68 *BFIT* 1 7.

¹⁴⁵⁵ Salom (2011) 65 *BFIT* 394 399.

¹⁴⁵⁶ See Wheeler (2005) 59 *BFIT* 477 478 for a list of the attribution terminology used in the OECD MTC.

¹⁴⁵⁷ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 297; Salom (2011) 65 *BFIT* 394 399–400; Danon (2014) 68 *BFIT* 1 7.

However, the OECD MTC itself does not contain any attribution principles.¹⁴⁵⁸ According to Wheeler, the Commentary contains some references to the attribution issue. The Commentary on article 10 deals with the situation in which the source state of a disguised dividend is faced with the attribution of the dividend to two persons resident in other states and proposes that the mutual agreement procedure be invoked to resolve the matter.¹⁴⁵⁹ The Commentary on article 1 suggests that the attribution of income is left to the domestic law of each state and is therefore unaffected by a DTT,¹⁴⁶⁰ but Wheeler doubts whether this paragraph is intended to apply outside the anti-avoidance context in which it was written. Article 17 and the Commentary on it accept that domestic law may attribute a performance fee directly to an individual, even if it is not paid to that individual. Wheeler infers from these statements in the Commentary that domestic law should be relied on to determine the attribution of income to a person.¹⁴⁶¹ Thus, attribution of income can be regarded as a matter for domestic law.¹⁴⁶² According to Danon it is *prima facie* arguable that by interpreting the words “paid to” or “derived by” (and the like) in accordance with article 3(2) of the OECD MTC,¹⁴⁶³ states may rely on their domestic attribution rules.¹⁴⁶⁴

If each state relies on its domestic attribution rules, states may disagree on the attribution of an item of income and it may lead to them taxing the income in the hands of different persons. Furthermore, they may disagree on the person entitled to treaty benefits or the person entitled to claim double taxation relief.¹⁴⁶⁵ Such a disagreement is known as a conflict of attribution.

A conflict of attribution must be distinguished from a conflict in the classification of an entity. The latter entails that one state regards an entity as being of one kind, whereas the other state regards the same entity as of another kind. For example, one state may classify an entity as a partnership, whilst another may classify that same entity as a company, resulting in different tax treatment in the respective states.¹⁴⁶⁶ The classification issue thus determines what the taxable entity should be,¹⁴⁶⁷ whereas the attribution issue assumes that there are taxable persons, but is concerned with the rights and obligations that give rise to a tax liability.¹⁴⁶⁸

¹⁴⁵⁸ Wheeler (2005) 59 *BFIT* 477 447; Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 296; Danon (2004) 32 *Intertax* 210 para 2A; Danon (2014) 68 *BFIT* 1 3.

¹⁴⁵⁹ Commentary on the OECD MTC art 10 para 29 and 30.

¹⁴⁶⁰ Commentary on the OECD MTC art 1 para 22.1.

¹⁴⁶¹ Wheeler (2011) 3 *World Tax Journal* 247 256.

¹⁴⁶² Wheeler (2005) 59 *BFIT* 477 487.

¹⁴⁶³ Article 3(2) provides that an undefined term will have the meaning under the tax laws (or if there is no such meaning in tax law, the meaning under any other law) of the state applying the DTT. If, however, the context requires otherwise, this domestic tax law meaning will not apply. For a more detailed discussion of this provision, see chs 5.2.1 and 5.2.6.

¹⁴⁶⁴ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 297.

¹⁴⁶⁵ Wheeler in *Cahiers de Droit Fiscal International: Conflicts in the Attribution of Income to a Person* 20.

¹⁴⁶⁶ OECD *The Application of The OECD Model Tax Convention to Partnerships* para 17.

¹⁴⁶⁷ See ch 5.6 for a discussion of the classification issue.

¹⁴⁶⁸ Wheeler (2005) 59 *BFIT* 477 478; Wheeler (2011) 3 *World Tax Journal* 39 41.

Moreover, the attribution of income should be distinguished from the liable to tax requirement in article 4(1) of the OECD MTC.¹⁴⁶⁹ In terms of this article, a person will be regarded as a resident of a state if the person is, according to the laws of that state, liable to tax in it by reason of certain factors. As was pointed out earlier, the term liable to tax does not require that a person be liable to tax on a specific item of income in order to claim treaty benefits regarding that income. Provided that there is a general liability for tax and the person derives or receives income, the DTT will be applied, irrespective of whether the person is liable to tax on the specific item of income. Thus, the source state should as a first question determine whether a person is liable to tax (which may be a general liability to tax) and thereafter ascertain whether the particular item of income is attributed to that person.¹⁴⁷⁰

The wording of the OECD MTC (such as “paid to” or “derived by”) requires that a particular item of income be connected or attributed to the specific resident claiming the benefits of the DTT. Since the attribution of income is a matter for domestic law it is important to consider how each state will attribute the income arising to a trust. This chapter will therefore start with a brief review of the attribution of trust income in each of the relevant states discussed in this dissertation.¹⁴⁷¹ However, applying domestic attribution rules may lead to conflicts of attribution and therefore examples of conflicts of attribution involving trusts between the states relevant to this dissertation will be explored. For example, one state may attribute the relevant income to the trust (or the trustee) while the other state attributes the income to the beneficiary. Which party should then claim the benefits of the DTT? The view taken in this dissertation is that these conflicts should be resolved in DTTs. Hence, examples of possible solutions to these conflicts of attribution will be considered and the preferred solution will be applied to the examples discussed earlier. The chapter ends with a conclusion regarding conflicts of attribution involving trusts.

7.2 Review of the attribution of trust income¹⁴⁷²

7.2.1 South Africa

If, in a year of assessment, an ascertained beneficiary has a vested right to income, the income will be attributed to the beneficiary. If, in a given year, no beneficiary has a vested right to the income, the trust will be taxed on the income. The trust itself could therefore be a taxpayer, but if it is not taxed, the beneficiary will be taxed on the income.¹⁴⁷³ If, however, any of the anti-avoidance provisions of section 7 apply, the person to whom the income is attributed in terms of that section will be taxed, and not the trust or the beneficiary.¹⁴⁷⁴ Generally, income retains its nature as it passes through a trust and the trust is a mere

¹⁴⁶⁹ See ch 6.2.2 for a discussion of this requirement.

¹⁴⁷⁰ Salom (2011) 65 *BFIT* 394 400. See also Danon (2014) 68 *BFIT* 1 7.

¹⁴⁷¹ The taxation of trusts, which includes the issue of the attribution of income, was discussed in greater detail in ch 3. The aim of this paragraph is simply to recap, briefly, what was stated there and to highlight the appropriate points.

¹⁴⁷² In this dissertation, income is described as “attributed” to a person when that person is, in terms of income tax laws, entitled to that income, in other words, that person is the person to whom the income is allocated for tax purposes. Income may therefore be attributed to a person, although that person does not carry the tax burden.

¹⁴⁷³ See chs 3.2.1 and 3.2.2.

¹⁴⁷⁴ See ch 3.2.4.

conduit pipe. Income most likely does not retain its nature if it is accumulated by the trustee and distributed to beneficiaries in a later year.¹⁴⁷⁵

7.2.2 United Kingdom

The trustees are, by legislation, together treated as if they were a single, distinct person.¹⁴⁷⁶ In general, a trustee of a discretionary trust will be taxed on discretionary and accumulated income arising to the trustee and also on the making of a discretionary payment of income to a beneficiary.¹⁴⁷⁷ The beneficiary is liable to tax on the amount distributed to him or her by the trustee, but is given a credit for the taxes paid by the trustee.¹⁴⁷⁸ Generally, in the case of a fixed trust, the trustee is liable to tax on his or her income.¹⁴⁷⁹ The beneficiaries are also liable to tax on their income from the trust, but are given a credit for the tax paid by the trust.¹⁴⁸⁰ In the case of a settlor-interested trust, where payments are made to the minor unmarried children of the settlor, or where the income from abroad legislation applies, the income is taxed in the hands of the settlor.¹⁴⁸¹

7.2.3 Canada

A trust is regarded as an individual for income tax purposes and is thus a taxpayer that may be liable to tax on its income.¹⁴⁸² Broadly speaking, a trust is taxed to the extent that the income is not taxed in the beneficiary's hands. The trust may deduct the income that is taxed in the beneficiary's hands, whilst the beneficiary is taxed on the amount deducted by the trust and payable to the beneficiary.¹⁴⁸³ Under certain circumstances, the income is not taxed in the hands of the trust or the beneficiary, but is attributed to and taxed in the hands of the settlor.¹⁴⁸⁴

7.2.4 The Netherlands

In general, the income of the trust will be taxed in the hands of the settlor, if the *Afgezonderd Particulier Vermogen* (APV) legislation is applicable.¹⁴⁸⁵

¹⁴⁷⁵ See ch 3.2.3.

¹⁴⁷⁶ See ch 3.3.1.

¹⁴⁷⁷ See ch 3.3.2.1. The relevant credit eliminates double taxation.

¹⁴⁷⁸ See ch 3.3.2.2.1.

¹⁴⁷⁹ See ch 3.3.3.1.

¹⁴⁸⁰ See ch 3.3.3.2.

¹⁴⁸¹ See chs 3.3.4 to 3.3.6.

¹⁴⁸² See ch 3.4.1.

¹⁴⁸³ See chs 3.4.2 and 3.4.3. Even though the trust is granted a deduction for the income paid to the beneficiary, the income is firstly attributed to the trust. It will be recalled that foreign source income received by the trust, so designated by the trust and included in the income of the beneficiary, is deemed to be income from that foreign source in the hands of the beneficiary. However, this deeming provision is only relevant for the purposes of the foreign tax credit rules and it is therefore submitted that it is not relevant for purposes of the attribution question in general (see ch 3.4.4). If this submission is incorrect, then it is assumed here that the trust has not designated the foreign income, with the effect that the income will not retain its nature. This argument applies to all the examples below.

¹⁴⁸⁴ See ch 3.4.5.

¹⁴⁸⁵ See ch 3.5.2.

7.2.5 Conclusion

In the case of a discretionary trust where the income is distributed to the beneficiaries in the same year, the income will be (a) taxed in the hands of the beneficiary in South Africa; (b) taxed in the trustee's hands and the beneficiary's hands in the United Kingdom, with the beneficiary being given a credit for the taxes paid by the trustee; (c) included in the trust's income and again deducted, and ultimately included in the beneficiary's income in Canada; and (d) taxed in the settlor's hands in the Netherlands.

In the case of a fixed trust, the same conclusions as above will be reached, save in the Netherlands, where a fixed trust will (possibly) not be regarded as an APV, with the result that the income will not be attributed to the settlor.

Where the income is accumulated in a discretionary trust, it will be taxed in the hands of the trust in South Africa and Canada and in the hands of the trustee in the United Kingdom. If the trust is regarded as an APV, the income will be attributed to the settlor in the Netherlands.

7.3 Examples

In the examples below, conflicts of attribution involving trusts in the states regarded in this dissertation are discussed. In all of these examples it is assumed that a DTT worded exactly like the OECD MTC is used and not the actual treaty between the two relevant states.

7.3.1 Income sourced in one state, but trust, trustee, beneficiaries and settlor resident in the other state

In cases where income is sourced in one state (the "source state"), but the trust, trustee, beneficiaries and the settlor are all resident in the other state (the "resident state"), a conflict of attribution often poses no problems. Once the source state has determined that the party to whom it attributes the income is resident in the resident state, it will be obliged to reduce its tax claim in accordance with the treaty.

Thus, it is submitted that where South Africa is the source state, it will be obliged to reduce its tax claim if the beneficiary (in the case of a vesting (fixed) trust or a discretionary trust that distributes all of its income to its beneficiaries during the relevant year) or the trust (in the case of a discretionary trust that accumulates all its income during the relevant year) is resident in the resident state (the United Kingdom or Canada).¹⁴⁸⁶ It is further submitted that even if South Africa were to take into account the fact that the United Kingdom attributes the income to both¹⁴⁸⁷ the trustee¹⁴⁸⁸ and the beneficiary¹⁴⁸⁹ and that Canada

¹⁴⁸⁶ It is highly unlikely that a trust will be regarded as resident in the Netherlands (see ch 6.3.4).

¹⁴⁸⁷ According to Wheeler (Wheeler (2011) 3 *World Tax Journal* 247 278), if double attribution (in other words the attribution of the same income to two persons) occurs within one state (as is the case with the trustee and beneficiary in the United Kingdom), it is obvious that a DTT concluded by that state should apply. She admits that it is less obvious which person should claim the treaty benefits and very tentatively suggests that in the case of trusts the beneficiary may be the correct claimant, based on the argument that only the beneficiary can be the beneficial owner. It is submitted that it would be very difficult to argue that either of the two persons to whom income is attributed cannot claim the treaty benefits. In the case where the other state (South Africa in

attributes the income to the trust (in the case of a discretionary trust that distributes all of its income to its beneficiaries during the relevant year or in the case of a vesting (fixed) trust), the point remains that all of these persons (trustee, beneficiary and the trust) are also resident in the relevant resident state. Hence, it may be argued that South Africa will be obliged to limit its taxing rights in accordance with the DTT.¹⁴⁹⁰

In cases where South Africa is the resident state and the income is, for example, sourced in the United Kingdom, the latter would have to determine whether the trustee (in the case of a discretionary trust that accumulates all of its income during the relevant year) or the trustee and the beneficiary (in the case of a vesting (fixed) trust and a discretionary trust that distributes all of its income during the relevant year) to whom (it is submitted) it attributes the income, is resident in South Africa. It is submitted that if the trustee (and beneficiary) is resident in South Africa, the United Kingdom would be obliged to reduce its tax claim in accordance with the DTT. Even if the United Kingdom were to take into account the fact that South Africa attributes the income to the trust (in the case of a discretionary trust that accumulates all of its income during the relevant year) and to the beneficiary (in the other cases), both the trust and the beneficiary would be resident in South Africa and it is therefore likely that the United Kingdom would have to reduce its tax claim.

Notwithstanding what is stated in this paragraph, some problematic cases may be identified where the conflict of attribution between South Africa and the other states under discussion in this dissertation may lead to double taxation. Three examples of problematic cases are discussed below:

7.3.1.1 Assume that a trust that is resident in South Africa receives income from Canada. The trust is either a discretionary trust and the income received by the trust is distributed to the South African resident beneficiaries during the same year in which it was derived by the trust,¹⁴⁹¹ or the trust is a vesting (fixed) trust with all the

this case) attributes the income to the beneficiary, it seems evident to choose the beneficiary, since that choice will, in effect, eliminate any conflict of attribution.

¹⁴⁸⁸ It will be recalled from ch 3.3.3.2 that if a beneficiary of a fixed trust is entitled to the income of an English law trust (and certain other jurisdictions called “Baker jurisdictions”), the trust itself is not the source of the income, but the underlying assets are. However, it is submitted that *Reid’s Trustee v IRC* 14 TC 512 is authority for the proposition that the fact that income retains its nature (or does not retain its nature) is irrelevant in determining the trustee’s liability for taxation. In other words, the trustee will be liable to tax on income derived by it and it is irrelevant for purposes of determining the trustee’s liability whether the income retains its nature when it is passed on to the beneficiary. See also Wheeler (2011) 3 *World Tax Journal* 39 62.

¹⁴⁸⁹ However, if the trust is a fixed trust and the income is mandated to the beneficiary, the income is not attributed to the trustee and it is only attributed to the beneficiary.

¹⁴⁹⁰ Canadian domestic law provides that the beneficiary may claim a credit for the foreign taxes paid by the Canadian resident trust in respect of its foreign source income (Income Tax Act RSC 1985 (5th supp) ch 1 s 104(22); Brown in *Topical Analysis* para 4.3.2.2). Domestic law in the United Kingdom also allows beneficiaries to claim relief (see ch 3.3.2.2.2).

¹⁴⁹¹ A practical problem may arise in a situation where the income is not immediately distributed to the beneficiaries, but only after some time has lapsed (eg six months), but the distribution still occurs within the relevant tax year. At the time that the relief is claimed it may be unknown (to the relevant revenue authorities and even the trustees, the trust and/or the beneficiaries) that the income will be distributed to the beneficiary during the particular year. It is submitted that the source state should, at the time that the trust (or trustee) claims the benefits of the DTT (that is, at the time that it is unknown to all parties that the distribution will be made) treat the situation as if the trust is accumulating the income. Should the trustees at that stage know that

beneficiaries resident in South Africa. South Africa attributes the income to the beneficiaries. It is submitted that Canada attributes the income sourced in Canada to the trust. Therefore a conflict of attribution will arise between South Africa and Canada.

Applying the DTT, Canada will have to determine whether the payment was made to a resident of South Africa (namely the trust) in order to decide whether it will reduce its tax rate or refrain from taxing it. Canada may argue that the trust is not a resident of South Africa for purposes of the DTT and therefore not entitled to the benefits of the DTT.¹⁴⁹² In terms of this argument Canada will be able to tax the income in full, without providing a reduction in terms of the DTT. South Africa as the resident state will have to determine whether one of its residents (the beneficiary)¹⁴⁹³ derived income from Canada, which that state may tax in accordance with the provisions of the DTT. South Africa will be able to argue that it is only liable to grant relief from double taxation in respect of the tax that Canada should have charged in terms of the DTT. Hence, only partial relief will be obtained. Therefore the conflict of attribution between South Africa and Canada will result in double taxation.

- 7.3.1.2 A similar problem to the one described in 7.3.1.1 may arise between South Africa and the Netherlands. Assume that a trust that is resident in South Africa receives income from the Netherlands. The beneficiaries of the trust are resident in South Africa and have vested rights (a fixed interest) in the income. South Africa would attribute the income to the beneficiary. The Netherlands may attribute some of the income to the trust. It is submitted that in applying its domestic law, the Netherlands will tax the income in the hands of the trust and will then apply the DTT to determine whether it is obliged to reduce the tax levied. It will have to determine whether the income was paid to a resident of South Africa and may argue that the trust is not a resident of South Africa for purposes of the DTT¹⁴⁹⁴ and that it is, consequently, not obliged to reduce its tax claim. South Africa, as the resident state, will have to determine whether one of its residents (the beneficiary)¹⁴⁹⁵ derived income from the Netherlands, which that state may tax in accordance with the provisions of the DTT. South Africa will be able to argue that it is only liable to grant relief from double taxation in respect of the tax that the

the income will be distributed to the beneficiaries in due course, the situation may have to be treated differently.

¹⁴⁹² It was concluded in ch 6.2.2.3.2 that a vesting trust is not liable to tax and therefore not a resident for DTT purposes. Furthermore, although there are differing views, it was submitted in ch 6.2.2.3.3 that, in the case of partially transparent entities, the beneficiaries would be entitled to the benefits of the DTT, in respect of that portion of the income which is taxed in the hands of the beneficiaries. Therefore, if in a particular year the income of a South African resident trust is distributed to the South African resident beneficiary, the beneficiary would be regarded as liable to tax in respect of that income. The trust would only be regarded as liable to tax in respect of the accumulated portion of the trust income. Therefore, if all the trust income for the year is distributed to the beneficiaries, it is the beneficiaries and not the trust that would be regarded as liable to tax and therefore resident for purposes of the DTT.

¹⁴⁹³ The trust will not have derived income.

¹⁴⁹⁴ It was concluded in ch 6.2.2.3.2 that a vesting trust is not liable to tax and therefore not a resident for DTT purposes.

¹⁴⁹⁵ The trust will not have derived income.

Netherlands should have charged in terms of the DTT. Hence, only partial relief will be obtained. Therefore the conflict of attribution between South Africa and the Netherlands will result in double taxation.

- 7.3.1.3 Assume that a discretionary trust that is resident in South Africa receives income from the Netherlands. The income received by the trust is either distributed during the relevant year, or not distributed (in other words, it is accumulated) to the South African resident beneficiaries. South Africa would attribute the income to the trust (if it is accumulated) or the beneficiary (if it is distributed), but the Netherlands would probably attribute the income to the settlor, who is assumed to be resident in South Africa. Therefore a conflict of attribution will arise between South Africa and the Netherlands.

In applying its domestic law, the Netherlands will most likely regard the income as paid to the settlor, a South African resident, and reduce its taxes accordingly in terms of the DTT. South Africa, on the other hand, may argue that it is not obliged to grant relief for double taxation, since the Netherlands did not levy tax in accordance with the DTT, because the income was not paid to or derived by the settlor in terms of South African law. Thus the conflict of attribution will result in double taxation.

7.3.2 Income attributed to another

All of the states discussed in this dissertation have rules which attribute the trust income to another person (typically the settlor)¹⁴⁹⁶ under certain circumstances. In an earlier chapter it was ascertained that these states attribute the income to the settlor under broadly similar circumstances, the exceptions being the Netherlands (that almost invariably attribute trust income to the settlor where the APV regime applies) and South Africa (which, additionally, attributes income to the settlor if, broadly speaking, the beneficiary's receipt of the income is delayed until the happening of an event stipulated by the settlor). Furthermore, South Africa and the United Kingdom attribute income to the settlor when a resident settlor transfers assets to a non-resident trust and certain requirements are met.¹⁴⁹⁷ This latter case will be discussed below as an example of how this type of attribution provision may lead to a conflict of attribution resulting in double taxation.

However, before that is done, the position where both states attribute the income to the settlor has to be considered. Wheeler questions whether the DTT applies to the settlor in respect of the trust income where both states attribute the income to the settlor. She argues that there might be a treaty attribution rule (based on the ownership of the income rather than the obligation to pay tax) that applies independently of the domestic law attribution of the two states.¹⁴⁹⁸ If Wheeler's argument is correct, it would imply that the settlor (who is

¹⁴⁹⁶ In the examples that follow, the settlor is used as the person to whom the income is attributed. Although income is not always attributed to the settlor, it is most often the case. It is submitted that if income is attributed to a person other than the settlor, the arguments advanced in these examples could be applied with the necessary adjustments. However, the Netherlands almost invariably attributes the income to the settlor. If South Africa attributes the income to another person, a conflict of attribution will arise.

¹⁴⁹⁷ See ch 3.6.

¹⁴⁹⁸ Wheeler (2011) 3 *World Tax Journal* 247 279.

not the owner of the income, but is liable to tax on the income in both states) will not be able to rely on the DTT. Danon, on the other hand, is of the view that the source state would regard the income as being paid to or derived by a resident of the resident state (the settlor) and would, therefore, reduce its tax claim. He concludes that double taxation of the income would therefore be avoided.¹⁴⁹⁹

If Danon's view is followed, only those cases in which South Africa attributes income to the settlor, but the other relevant states do not, will result in a conflict of attribution. The application of section 7(8)¹⁵⁰⁰ is used as an example of such an attribution rule. Assume that income is derived from a Canadian source¹⁵⁰¹ and the trust is resident in Canada.¹⁵⁰² The settlor is assumed to be resident in South Africa and has donated an asset to the trust that generates the relevant Canadian source income. Both in the case of a discretionary trust (irrespective of whether it distributes or accumulates the income during the relevant year) and a vesting (fixed) trust, South Africa will most likely attribute the income to the settlor (on the basis that the requirements of section 7(8) have been met). If Canada applies its own domestic tax law, it will probably attribute the income to the trust.

It is submitted that Canada will not consider the DTT as applicable, since it is merely taxing Canadian source income paid to a Canadian resident (the trust). However, South Africa will attribute the income, in terms of s 7(8) of the Income Tax Act to the settlor who is resident in South Africa. Thus a conflict of attribution will occur.

7.3.3 Other selected examples

7.3.3.1 Assume that a vesting trust is resident in Canada. It receives income from a Canadian source to which a beneficiary, resident in South Africa, has a vested right.

Canada, as the source state, will apply its domestic law and, it is submitted, attribute the income to the trust. Canada will be able to argue that the DTT with South Africa does not apply, since the trust is a Canadian resident and receives income from a Canadian source.¹⁵⁰³ From a South African point of view, the beneficiary will be regarded as liable to tax on the trust income. Therefore the same

¹⁴⁹⁹ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 306–307.

¹⁵⁰⁰ It will be recalled that the Income Tax Act 58 of 1962 s 7(8) provides that where, by reason of or in consequence of any donation, settlement or other disposition made by any resident, any amount is received by or accrued to any person (such as a trust) who is not a resident, which would have constituted income had that person been a resident, there shall be included in the income of that resident so much of that amount as is attributable to that donation, settlement or other disposition (see ch 3.2.4).

¹⁵⁰¹ If South Africa is the resident state (that is, the trust is resident in South Africa), s 7(8) does not apply. See ch 3.2.4 and 3.2.2. According to Jooste, s 7(8) also applies in respect of income from a South African source (Jooste (2002) *Acta Juridica* 186 188).

¹⁵⁰² The United Kingdom position is not discussed here as it is assumed that both states will apply their relevant legislation, namely s 7(8) in the case of South Africa and the transfer of assets abroad legislation in the United Kingdom. Although the scope of the legislation differs (see ch 3.6), it is assumed for purposes of this example that the circumstances are thus that both provisions apply. Since it is highly unlikely that a trust will be regarded as resident in the Netherlands (see ch 6.3.4), the conflicts of attribution between South Africa and the Netherlands (to the extent that conflicts will arise) are not discussed any further.

¹⁵⁰³ Canada will, however, charge a withholding tax on the payment of the amount to the non-resident beneficiary. This is ignored for purposes of this example.

trust income will be taxed in Canada in the hands of the trust and in South Africa in the hands of the beneficiary due to the conflict of attribution.

- 7.3.3.2 Assume that a discretionary trust is resident in Canada. It receives income from a South African source. The trustee decides to accumulate the income and none of the income is therefore distributed to the beneficiary who is resident in the Netherlands. The settlor is also resident in the Netherlands.

In applying its domestic law, South Africa will attribute the income to the trust. It is submitted that in terms of Canadian domestic law, the income will also be attributed to the trust. Since the trust is resident in Canada, South Africa will be obliged to limit its taxing rights in accordance with the DTT. It is submitted that Canada will be obliged to grant relief from double taxation to the trust, since it derived the income which South Africa was entitled to tax in accordance with the DTT. No conflict of attribution will arise.

In the Netherlands, the settlor will probably be liable to tax on the income earned by the Canadian trust. South Africa, as the source state, will be able to argue that the income was not paid to or derived by the settlor and that the DTT between South Africa and the Netherlands should therefore not apply.¹⁵⁰⁴ Hence a conflict of attribution will arise, which will result in the same income being taxed in South Africa or Canada and in the Netherlands.

- 7.3.3.3 Assume that a vesting (fixed) trust is resident in Canada. The trust receives income from a South African source. There are two beneficiaries with vested (fixed) rights to the income. Beneficiary one is resident in Canada and beneficiary two is resident in South Africa.

If South Africa applies its domestic law, it will attribute the income to the respective beneficiaries. Since beneficiary one is a resident of Canada, South Africa will regard his or her portion of the income as paid to a resident of Canada and therefore South Africa will probably be obliged to limit its taxing rights in accordance with the DTT in respect of that portion. South Africa may argue that it is entitled to tax beneficiary two in full on his or her portion of the income, since beneficiary two is a South African resident and that he or she is being taxed on the basis of his or her residence. If Canada applies its domestic law, it may regard the full amount (both beneficiary one and two's portions) as paid to the trust. Canada, as the resident state will have to decide whether or not to grant relief from double taxation. If the trust were to apply for such relief, Canada could argue that it is only obliged to grant relief for taxes levied by South Africa in accordance with the DTT and that South Africa's taxation of beneficiary two was not in accordance with the treaty. Canada could probably refuse to grant relief to beneficiary one, as beneficiary one did not derive income in accordance with Canada's domestic law. Hence, a conflict of attribution will occur.

¹⁵⁰⁴ See also Wheeler, who argues that a state faced with a claim to treaty benefits from two states could answer it with the technical objection that income can be paid to or received by only one person at a time (Wheeler (2011) 3 *World Tax Journal* 247 277).

7.4 Possible solutions to conflicts of attribution

7.4.1 Should conflicts of attribution be resolved?

According to Wheeler the attribution of income should be left to domestic law. A DTT, on the other hand, regulates the interface between the two states' tax systems and is, therefore, the ideal instrument to deal with conflicts of attribution.¹⁵⁰⁵

Danon, however, emphasises the distinction between juridical and economic double taxation.¹⁵⁰⁶ A conflict of attribution does not, strictly speaking, fall within the definition of juridical double taxation, because two different taxpayers are taxed. However, Danon argues that a conflict of attribution can be distinguished from other forms of economic double taxation (such as the taxation of corporate profits and dividends), since a conflict of attribution entails the simultaneous taxation of the same income in the hands of two persons, because the tax authorities of the two states allocate the income differently. In the case of corporate profits and dividends, two persons are taxed in succession on income that passes from one person to another and it is clear from the OECD MTC that this form of economic double taxation is not intended to be removed. Furthermore, an attribution conflict can also be distinguished from another example of economic double taxation, namely the adjustment of a non-arm's length transfer price in terms of article 9(1) and a corresponding adjustment in terms of article 9(2). According to Danon, article 9 deals with a "residence-residence" conflict because the two legally independent enterprises are both regarded as resident in their respective states. Article 9 thus aims to resolve economic double taxation where the same profits are taxed in the hands of two associated enterprises, each resident in one of the contracting states. A conflict of attribution, on the other hand, involves a "residence-source" conflict because both the state of source and the state of residence want to tax.¹⁵⁰⁷

Danon refers to the dissenting view of Lang, who concludes that a conflict of attribution should not be eliminated as it does not fall within article 9 of the OECD MTC.¹⁵⁰⁸ Salom does not agree with Lang's opinion, as it fails to take into account the distinction between conflicts where a source state and a residence state are involved and a conflict in which two residence states are involved. As article 9 only deals with residence-residence conflicts, no conclusion should be drawn regarding a source-residence conflict.¹⁵⁰⁹

As pointed out earlier, the OECD MTC does not stipulate to whom the income should be attributed. Salom points out that it would, therefore, be strange to argue that the distributive rules nevertheless require the income to be attributed to the same person by the two contracting states. She further argues that article 4(1) of the OECD MTC would

¹⁵⁰⁵ Wheeler (2005) 59 *BFIT* 477 487.

¹⁵⁰⁶ Juridical double taxation is defined as the imposition of comparable taxes in two or more states on the same taxpayer in respect of the same taxable income. Economic double taxation is the imposition of comparable taxes by two or more states on different taxpayers in respect of the same taxable income (Larking *IBFD International Tax Glossary* 134).

¹⁵⁰⁷ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 309–310; Danon (2004) 32 *Intertax* 210 para 3A.

¹⁵⁰⁸ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 310.

¹⁵⁰⁹ Salom (2011) 65 *BFIT* 394 402.

become meaningless if the source state could refuse to apply a DTT, because, under its own law, the income is not attributed to the other state's residents.¹⁵¹⁰

Referring to the objective of DTTs, namely to avoid double taxation, Salom further argues that the OECD MTC cannot be interpreted in a way that would leave all forms of economic double taxation unresolved.¹⁵¹¹

It is submitted that the arguments presented by Danon, Wheeler and Salom are convincing and therefore conflicts of attribution should be resolved. A number of possible solutions have been suggested. Some of these are examined in turn below.

7.4.2 Approach similar to that of the Partnership Report

A solution advocated by Danon entails that the principles of the Partnership Report¹⁵¹² should be adapted and applied¹⁵¹³ to conflicts of attribution involving trusts. His argument starts by considering the literal meaning of the terms "paid to" and "derived by" and the like and concludes that the text of the distributive rules "does not reveal that these provisions only apply where the contracting States' internal law attribute the relevant item of income to the same taxpayer. Rather, these articles solely regulate the allocation of taxing rights between the two jurisdictions".¹⁵¹⁴ Therefore, based on the wording of the provisions, the distributive rules will apply, even if the income is taxed in the hands of different taxpayers. According to Danon, this interpretation is supported if the context of the DTT as well as the object and purpose of the distributive rules are considered. He argues that it should not be inferred from the Commentary, which suggests that only juridical double taxation are dealt with in the OECD MTC, that conflicts of attribution fall outside the scope of the OECD MTC.¹⁵¹⁵

He therefore suggests that the terms "paid to" and "derived by" and the like should not be interpreted in accordance with their domestic law meaning, but should rather be given an autonomous meaning. In terms of article 3(2) of the OECD MTC, he argues that a meaning based on the context of the OECD MTC should be given to these terms.¹⁵¹⁶ Two possible contextual meanings are identified. The first is the meaning based on trust law. In terms of this meaning, income is "paid to" or "derived by" a beneficiary with a vested right to income (whether the beneficiary has a vested right *ab initio* or through the exercise by the trustee of his or her discretion in favour of the beneficiary during the relevant tax year). In all other cases the income would be "paid to" or "derived by" the trustee. However, he prefers the

¹⁵¹⁰ Salom (2011) 65 *BFIT* 394 402.

¹⁵¹¹ Salom (2011) 65 *BFIT* 394 402.

¹⁵¹² OECD *The Application of The OECD Model Tax Convention to Partnerships*.

¹⁵¹³ With one exception which is discussed in ch 7.5.4.1.

¹⁵¹⁴ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 311.

¹⁵¹⁵ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 311–314.

¹⁵¹⁶ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 314–315.

second meaning, because the first meaning (based on trust law) does not resolve a conflict of attribution where the income is attributed to the settlor.¹⁵¹⁷

The second meaning is based on the solution suggested for conflicts of classification of partnerships contained in the Partnership Report. According to Danon, if these solutions correctly reflect the contextual meaning of the terms “paid to” or “derived by”, they may be applied to trusts.¹⁵¹⁸ The solution provided by the Partnership Report entails, in principle, that

“the source State, in applying the Convention where partnerships are involved, should take into account, as part of the factual context in which the Convention is to be applied, the way in which an item of income arising in its jurisdiction is treated in the jurisdiction of the taxpayer claiming the benefits of the treaty as a resident. If that State ‘flows through’ the income to the partner, then the partner should be considered liable to tax and entitled to the benefits of the Convention of the State of which he is a resident”.¹⁵¹⁹

Danon argues that, in terms of the Partnership Report, a state of source should regard an item of income as “paid to” or “derived by” a resident of the other contracting state if this latter state attributes the item of income to the person claiming the DTT benefits as a resident.¹⁵²⁰ Danon critically analyses the Partnership Report’s solution and concludes that this Report “codifies the appropriate contextual interpretation of the term ‘paid to/derived by’ contained in the distributive rules”.¹⁵²¹ He thus infers that if an item of income arises in the state of source, it should be regarded as “paid to” or “derived by” a resident of the other contracting state, if the latter state attributes the income to this resident for fiscal purposes. Furthermore, he opines that there is no reason why this solution cannot be applied to conflicts of attribution involving trusts.¹⁵²²

Wheeler describes the possibility of using the solution offered by the Partnership Report (namely, giving the prerogative to the residence state) in respect of conflicts of attribution,

¹⁵¹⁷ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 315–316.

¹⁵¹⁸ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 317. Therefore, although there is a difference between conflicts of classification and conflicts of attribution, Danon is of the view that the issues posed by both problems are very similar.

¹⁵¹⁹ OECD *The Application of The OECD Model Tax Convention to Partnerships* para 53. See also Commentary on the OECD MTC art 1 para 6.3.

¹⁵²⁰ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 317.

¹⁵²¹ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 323. Danon does not, however, agree with the exception contained in example 16 in para 124 of the OECD *The Application of The OECD Model Tax Convention to Partnerships*, on the basis that this approach is inconsistent with the principle (see ch 7.5.4.1). See also Danon (2014) 68 *BFIT* 1 11.

¹⁵²² Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 323. Salom seems to support Danon’s view that the solution in the Partnership Report reflects the correct interpretation of the OECD MTC and that this solution can be applied to other cases of conflicts of attribution, which would include trusts (Salom (2011) 65 *BFIT* 394 403–404). See also Danon (2014) 68 *BFIT* 1 12.

as “attractive”.¹⁵²³ However, she points out that the source state may not always be willing to accept the resident state’s attribution, especially if the attribution is not based on well-known bases of attribution. Moreover, she argues that there is a qualitative difference between a conflict of attribution and a conflict of classification. Regarding classification, each state has to decide whether it wishes to tax an accumulation of persons (whether individuals or business structures) or assets as a taxable person under domestic law. Therefore, only one end of the treaty relationship is involved and therefore only the state imposing the liability should determine this point. However, the attribution of income deals with the direction of flow of income and involves the two points at each end of the flow. Therefore, determining the direction of the flow should not be determined by only one state (the resident state).¹⁵²⁴

Steindl and Stianstny argue that the solution provided in the Partnership Report should be able to provide a solution in tax avoidance situations. However, they conclude that, from a policy perspective, “it does not seem to be an appropriate tool to combat tax avoidance”.¹⁵²⁵

7.4.3 Tiebreaker

Wheeler offers what she admits to be a new departure, namely that a tiebreaker clause be inserted into DTTs to resolve the competing attribution rules of the two states.¹⁵²⁶ Such a tiebreaker would consist of “a hierarchy of connections between a person and income to determine which attribution takes priority”.¹⁵²⁷ She concedes that this solution would only operate within one bilateral DTT, whereas attribution conflicts often cause triangular situations. However, she argues that the solution should not be dismissed for that reason alone as it is an inevitable result of applying a bilateral DTT to a multilateral world. She concludes that, although it is not perfect, this solution shows some promise.¹⁵²⁸

7.4.4 Attribution according to source state

In determining its withholding tax rate, the state of source should be allowed to determine to whom the income is attributed. The resident state will attribute the income at the stage when it decides whether it will grant a tax credit or a tax exemption. Although this solution is simple, it does not solve the double taxation involved in certain situations and, according to Salom, should therefore not be supported.¹⁵²⁹ However, this approach finds support from Steindl and Stianstny who argue that from a policy perspective, it is an appropriate measure to resolve conflicts of income allocation and, in addition, it combats tax avoidance.¹⁵³⁰

¹⁵²³ Wheeler (2011) 3 *World Tax Journal* 247 260. Wheeler also discusses the possibility of using the solution contained in the Partnership Report in respect of characterisation as a solution in respect of attribution conflicts. However, she dismisses this solution as clearly not capable of dealing with conflicts of attribution.

¹⁵²⁴ Wheeler (2011) 3 *World Tax Journal* 247 260–261.

¹⁵²⁵ Steindl and Stianstny (2014) 68 *BFIT* 112 113.

¹⁵²⁶ Wheeler (2005) 59 *BFIT* 477 488.

¹⁵²⁷ Wheeler (2011) 3 *World Tax Journal* 247 265.

¹⁵²⁸ Wheeler (2011) 3 *World Tax Journal* 247 265.

¹⁵²⁹ Salom (2011) 65 *BFIT* 394 403.

¹⁵³⁰ Steindl and Stianstny (2014) 68 *BFIT* 112 114.

7.4.5 Autonomous attribution

It has been suggested that the words in each of the distributive provisions of the OECD MTC (for example “paid to”) should be interpreted, so that it may be determined to whom the income should be attributed. Salom counters this view by arguing that the relevant words in each of the distributive articles do not establish to whom income should be attributed.¹⁵³¹

7.4.6 Conclusion

From the above, it may be deduced that only two of the proposed solutions are feasible:¹⁵³² the application of the solution in the Partnership Report or the addition of a tiebreaker to the OECD MTC. The latter of these two solutions would involve an amendment to the OECD MTC and its further discussion therefore falls outside the scope of this dissertation. In the following paragraph the solution offered in the Partnership Report will be applied to the conflicts of attribution in respect of trusts in which South Africa may be involved and which were identified above.

7.5 Application of the approach similar to that of the Partnership Report to trusts

Before the solution similar to the one suggested in the Partnership Report is applied to the examples discussed above, a point regarding the methodology involved in such application should be considered. Hattingh, writing in the context of the application of DTTs to partnerships, asserts that such application can be very complex in circumstances where the tax and/or legal treatment of the partnership as a transparent or opaque entity differs between the two states that are parties to the DTT. He therefore suggests that a clear and consistent methodology be applied. The first step would be to establish the nature of the tax treatment under the two domestic tax systems. Thereafter, the focus shifts to the DTT to determine whether it changes the result that was reached when the two domestic tax systems were applied. Hattingh provides the steps to be followed in respect of a specific set of facts, but concludes that the best methodology is to start “from the source state perspective to establish any restrictions on its taxing rights, and working towards the residence country’s obligations under a Tax Treaty”.¹⁵³³ Using this methodology, the solution similar to the one suggested in the Partnership Report will now be applied to the examples discussed above in which there was a conflict of attribution.

7.5.1 Income sourced in one state, but trust, trustee, beneficiaries and settlor resident in the other state

7.5.1.1 Assume that a trust that is resident in South Africa receives income from Canada. The trust is either a discretionary trust that distributes the income to the

¹⁵³¹ Salom (2011) 65 *BFIT* 394 402.

¹⁵³² Although there is some support for the solution that involves using the source state’s attribution, this solution is not applied further, as this solution is not supported by the OECD. The OECD has clearly endorsed the solution proposed by the Partnership Report by incorporating its findings into the Commentary on the OECD MTC.

¹⁵³³ Hattingh (2010) 127 *SALJ* 38 49–50.

beneficiary during the same year or a vesting (fixed) trust. The beneficiary is resident in South Africa.¹⁵³⁴

It is submitted that Canada will apply its domestic law and attribute the income to the trust, which is resident in South Africa. It is then required to apply the DTT to determine whether it should restrict its taxing rights. It may then take into account, as part of the factual context, that South Africa attributes the income to the beneficiary and, accordingly, apply the DTT to regard the income as being paid to or derived by the beneficiary (the person to whom the resident state attributes the income). Hence, it is submitted, the conflict of attribution will be eliminated.

- 7.5.1.2 Assume that a vesting (fixed) trust that is resident in South Africa receives income from the Netherlands. The beneficiary is resident in South Africa.¹⁵³⁵

In applying its domestic law, it is submitted that the Netherlands will attribute some of the income to the trust (*doelvermogen*). The Netherlands will then consider the provisions of the DTT to determine whether it must reduce its tax claim. If it takes the attribution of the income by South Africa to the beneficiary into account as part of the factual context, the Netherlands would most likely consider the income as paid to or derived by the beneficiary, thereby eliminating the conflict of attribution.

- 7.5.1.3 Assume that a trust that is resident in South Africa receives income from the Netherlands.¹⁵³⁶ The trust is a discretionary trust that either distributes the income to the beneficiary during the same year or accumulates the income in the hands of the trust. The beneficiary and the settlor is resident in South Africa.¹⁵³⁷

It is submitted that the Netherlands will apply its domestic law and attribute the income to the settlor. It may then consider the provisions of the DTT to determine whether it is obliged to reduce its tax claim. In applying the DTT, it may take into account, as part of the factual context, that South Africa attributes the income to the beneficiary (in the case of distribution) or the trust (in the case of accumulation). It may be argued that the Netherlands will, accordingly, regard the income as paid to or derived by the beneficiary or the trust, respectively, since the resident state attributes the income to the beneficiary or the trust. Hence, it is submitted that the conflict will be eliminated.

¹⁵³⁴ This example corresponds with example 7.3.1.1.

¹⁵³⁵ This example corresponds with examples 7.3.1.2.

¹⁵³⁶ The Netherlands has entered an observation to the Commentary on art 1 of the OECD MTC in relation to partnerships. The observation reads as follows: "The Netherlands will adhere to the conclusions on the application of the Convention to partnerships incorporated in the Commentary on Article 1 and in the Commentary on the other relevant provisions of the Convention only, and to the extent to which it is explicitly so confirmed in a specific tax treaty, as a result of mutual agreement between competent authorities as meant in Article 25 of the Convention or as unilateral policy." To the extent that the Netherlands does not adhere to the conclusions on the application of the DTT to partnerships in the Commentary, the solution suggested in these examples (7.5.1.2 and 7.5.1.3) will not apply.

¹⁵³⁷ This example corresponds with example 7.3.1.3.

7.5.2 Income attributed to settlor

Assume that income is received from a Canadian source by a trust that is resident in Canada. The trust is either a discretionary trust (irrespective of whether it accumulates or distributes the income) or a vesting (fixed) trust. The settlor is resident in South Africa and all the other requirements of section 7(8) of the Income Tax act have been met.¹⁵³⁸

It is submitted that Canada will attribute the income to the trust in terms of its domestic law. South Africa, on the other hand, will attribute the income to the settlor in accordance with its domestic law. In terms of the majority view in the Partnership Report, it may be argued that Canada will not be obliged to limit its taxing rights as a result of the DTT. Thus it is submitted that the Partnership Report will not eliminate the double taxation resulting from the attribution conflict.¹⁵³⁹

7.5.3 Other selected examples

7.5.3.1 Assume that a vesting (fixed) trust is resident in Canada. It receives income from a Canadian source to which a beneficiary, resident in South Africa, has a vested right.¹⁵⁴⁰

It is argued above that Canada will attribute the income to the trust. Canada may argue that the DTT with South Africa does not apply, since the trust is a Canadian resident and receives income from a Canadian source. South Africa will attribute the income to the beneficiary. According to the majority view in the Partnership Report, the source state (Canada) is not required to take into account the treatment of the income in the resident state (South Africa) in this situation, as it is expected to do throughout the rest of the Partnership Report. The majority was of the view that the situation involves a purely domestic matter and its taxing rights cannot be limited in terms of the DTT.¹⁵⁴¹ Hence, it is submitted that the resulting double taxation due to the difference in attribution is not eliminated by the Partnership Report. The majority's view was incorporated into the Commentary dealing with this point.¹⁵⁴²

The minority was of the view that, even in the above situation, the source state (Canada) should follow the principle set out in the rest of the Partnership Report: that is, to take into account that South Africa attributes the income to the beneficiary. According to their view, Canada would, therefore, be obliged to limit its

¹⁵³⁸ This example corresponds with example 7.3.2.

¹⁵³⁹ See example 7.5.3.1 where the views of the majority and minority in the Partnership Report are discussed more fully.

¹⁵⁴⁰ This example corresponds with example 7.3.3.1.

¹⁵⁴¹ OECD *The Application of The OECD Model Tax Convention to Partnerships* para 131.

¹⁵⁴² Commentary on the OECD MTC art 1 para 6.1 reads as follows: "One issue is the effect that the application of the provisions of the Convention to a partnership can have on the taxation of the partners. Where a partnership is treated as a resident of a Contracting State, the provisions of the Convention that restrict the other Contracting State's right to tax the partnership on its income do not apply to restrict that other State's right to tax the partners who are its own residents on their share of the income of the partnership. Some states may wish to include in their conventions a provision that expressly confirms a Contracting State's right to tax resident partners on their share of the income of a partnership that is treated as a resident of the other State."

taxing rights. It is submitted that this view resolves the conflict of attribution and eliminates the double taxation which would otherwise ensue.¹⁵⁴³

Danon opines that the view of the majority should be rejected on the ground of inconsistency. He therefore supports the view of the minority.¹⁵⁴⁴ Although the majority's (and Danon's) view is to be preferred, it is submitted that if a court attaches much weight to the Commentary it will probably follow the majority's view, resulting in the conflict of attribution being left unresolved. As set out earlier, the Canadian courts attach an important role to the OECD Commentary as part of the interpretation process¹⁵⁴⁵ and it is submitted that the Canadian court will probably follow the Commentary on this point.

- 7.5.3.2 Assume that a discretionary trust is resident in Canada. It receives income from a South African source. The trustee decides to accumulate the income and none of the income is therefore distributed to the beneficiary, who is resident in the Netherlands.

The DTT between South Africa and Canada applies and it is submitted that South Africa (which attributes the income to the trust) will be obliged to reduce its tax claim, while Canada (which also attributes the income to the trust) will be obliged to grant double taxation relief to the trust.¹⁵⁴⁶

It is most likely that the Netherlands will attribute the income received by the Canadian trust to the settlor. In terms of the Partnership Report, South Africa would be obliged to take into account the fact that the Netherlands attributes the income to the settlor and therefore regard the income as paid to or derived by the settlor for purposes of the DTT between South Africa and the Netherlands. The effect is thus that both treaties would apply and that South Africa's taxing rights would be restricted in terms of both treaties. The lowest amount of tax allowed under the two treaties should be used to satisfy South Africa's obligation.¹⁵⁴⁷

- 7.5.3.3 A vesting (fixed) trust resident in Canada receives income from South Africa. Beneficiary one is resident in Canada and beneficiary two is resident in South Africa.¹⁵⁴⁸

¹⁵⁴³ OECD *The Application of The OECD Model Tax Convention to Partnerships* para 132.

¹⁵⁴⁴ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 322–323. See also Danon (2014) 68 *BFIT* 19.

¹⁵⁴⁵ See ch 4.3.4.

¹⁵⁴⁶ This example corresponds with example 7.3.3.2.

¹⁵⁴⁷ OECD *The Application of The OECD Model Tax Convention to Partnerships* paras 73–74. Wheeler raises the concern that double attribution caused by anti-avoidance legislation, which leads to a claim for double treaty relief, might be too generous by the source state. She concludes, however, that it would be impossible to distinguish the causes of double attribution. She argues that double attribution in cross-border situations can be divided into two constellations. In one of these constellations the income is sourced from a third state and there are two states that each attributes the income to a resident of theirs. This constellation is similar to the factual situation in the example under discussion. Wheeler states that the source state must make a choice between the two attributions (and gives an example of a French case in which this was done) or giving benefits under two treaties (Wheeler (2011) 3 *World Tax Journal* 247 278).

¹⁵⁴⁸ This example corresponds with example 7.3.3.3.

It is submitted that in terms of the majority view in the Partnership Report,¹⁵⁴⁹ South Africa will be entitled to tax beneficiary two, since it is taxing him or her on the basis of residence. South Africa will, however, be obliged to grant relief from double taxation to beneficiary two, thereby minimizing double taxation.¹⁵⁵⁰ The majority's view was incorporated into the Commentary dealing with this point.¹⁵⁵¹

If the minority view¹⁵⁵² were to apply, it may be argued that South Africa would be obliged to take into account that Canada attributes the income to the trust. Accordingly, South Africa would be obliged to limit its taxing rights in accordance with the DTT and Canada will be obliged to grant relief from double taxation to the trust. Hence the conflict of attribution will be avoided, with the result that double taxation will be eliminated.

7.6 Conclusion

The attribution of income involves the connection between an item of income and a specific taxpayer. One of the conditions for the application of the OECD MTC is that income must be attributed to a taxpayer. The various distributive rules in the OECD MTC use different words to connote this attribution. Yet, the OECD MTC itself does not contain any attribution principles and it is left to the domestic law of each state to determine how income will be attributed to taxpayers. Because these rules can differ from one state to another, conflicts of attribution can arise.

The majority of academic authors agree that conflicts of attribution should be resolved. One of the ways to solve conflicts of attribution is through the application of the principles contained in the Partnership Report. The main principle of the Report entails that the source state should take into account the way in which an item of income is treated in the resident state. It has been argued that this solution can also be applied to trusts, with the result that the state of source of an item should regard it as "paid to" or "derived by" a resident of the other contracting state (whether it be the trust, the trustee, the beneficiary or the settlor), if the latter state attributes the income to this resident for fiscal purposes.

Various examples of attribution conflicts between South Africa and the other relevant states discussed in this dissertation were given in this chapter. In relatively simple fact patterns, for instance, where the trust, trustee, beneficiary and settlor are resident in the same state, but income is received from another state, conflicts of attribution are often unproblematic. However, as the examples discussed in this dissertation illustrate, even under these circumstances conflicts of attribution may lead to double taxation. Further examples, which still used relatively uncomplicated fact patterns, but which are often found in trust structures, were also used to illustrate how conflicts of attribution can lead to double taxation.

¹⁵⁴⁹ OECD *The Application of The OECD Model Tax Convention to Partnerships* para 127.

¹⁵⁵⁰ OECD *The Application of The OECD Model Tax Convention to Partnerships* para 129. However, Danon is of the view that South Africa's obligation to provide relief from double taxation in these circumstances is limited to partnerships and cannot be applied to trusts, presumably because the trust cannot be viewed as the beneficiary's permanent establishment (Danon (2014) 68 *BFIT* 1 9).

¹⁵⁵¹ See example 7.5.3.1.

¹⁵⁵² OECD *The Application of The OECD Model Tax Convention to Partnerships* para 126.

It is submitted that the conflicts of attribution found in the examples discussed in this dissertation were caused by (a) the different treatment by states of trusts for tax purposes, namely either as transparent or opaque¹⁵⁵³ and (b) states' specific attribution rules that attribute the income to the settlor.¹⁵⁵⁴

Many of these conflicts of attribution¹⁵⁵⁵ can be solved if the solution set out in the Partnership Report is applied to the trusts and participants to the trusts in question. Although the examples used in this chapter contain fairly simple fact patterns, it is submitted that they illustrate that the solution suggested in the Partnership Report can be applied to resolve conflicts of attribution involving trusts. Although this approach will not solve all the conflicts of attribution involving trusts (as was illustrated, for instance, in examples 7.5.4 and 7.5.5.1),¹⁵⁵⁶ it is consistent with the solution already used in respect of partnerships (which is endorsed by the OECD). It is therefore submitted that, in practice, the Partnership Report should be used as guidance to resolve conflicts of attribution in relation to trusts, including in instances where more complex fact patterns may be encountered. In this regard, the use of a clear methodology is supported.

¹⁵⁵³ See examples 7.3.1.1 and 7.3.1.2 and 7.3.3.3.

¹⁵⁵⁴ See examples 7.3.1.3, 7.3.2 and 7.3.3.2.

¹⁵⁵⁵ If the minority view in the Partnership Report is adopted in examples 7.5.2, 7.5.3.1 and 7.5.3.3 the conflicts of attribution will also be resolved by the application of the Partnership Report.

¹⁵⁵⁶ See also Danon (2014) 68 *BFIT* 1 10–11.

CHAPTER 8

BENEFICIAL OWNERSHIP AND A TRUST

Chapter overview	247
8.1 Introduction	248
8.2 Difficulties surrounding the interpretation of beneficial ownership	250
8.2.1 Domestic law meaning in accordance with the context of the DTT?	250
8.2.1.1 South Africa	253
8.2.1.2 United Kingdom	256
8.2.1.3 Canada	258
8.2.1.4 The Netherlands	259
8.2.2 Other difficulties	260
8.3 The OECD Commentary on the meaning of beneficial ownership	260
8.4 Case law on the meaning of beneficial ownership	264
8.5 Views of academic authors on the meaning of beneficial ownership	273
8.6 Can a trust (or a trustee) be a beneficial owner?	276
8.6.1 The views of academic authors	276
8.6.2 The case law	279
8.6.3 OECD revised proposals: October 2012	280
8.6.4 Conclusion regarding the question whether a trust can be a beneficial owner	284
8.7 Conclusion	287
8.7.1 General	287
8.7.2 Can a trust be the beneficial owner of income?	289
8.7.3 The different states	290
8.7.4 Closing remarks	290

8.1 Introduction

Articles 10, 11¹⁵⁵⁷ and 12¹⁵⁵⁸ of the Organisation for Economic Co-operation and Development Model Tax Convention (OECD MTC), which deal with dividends, interest and royalties, respectively, use the term beneficial owner as part of the requirement for relief in terms of the article. For example, articles 10(1) and (2) of the OECD MTC read as follows:

- “(1) Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.
- (2) However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:
 - (a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends;
 - (b) 15 per cent of the gross amount of the dividends in all other cases.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.”

In all three of the articles, a resident may only qualify for relief if that resident is also the beneficial owner¹⁵⁵⁹ of the relevant income. Trusts (or trustees) claiming relief in terms of these provisions would therefore have to show that they are the beneficial owners of the relevant income.

The requirement that the resident claiming relief is also the beneficial owner was inserted into the text of all three of the articles in 1977.¹⁵⁶⁰ The purpose of inserting the provision was to curb treaty shopping.¹⁵⁶¹ The term beneficial ownership is not defined in the OECD

¹⁵⁵⁷ Articles 11(1) and (2) read as follows: “(1) Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State. (2) However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.”

¹⁵⁵⁸ Article 12(1) reads as follows: “Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State”.

¹⁵⁵⁹ In this dissertation the terms beneficial owner and beneficial ownership are used interchangeably as it is submitted that these terms mean the same thing. This view is shared by Prebble (2008) VIII *Trusts and Tax Treaties* 75 76. Strictly speaking beneficial ownership is not a term, but a concept. However, the word “term” was used in other parts of this dissertation (eg ch 5) in relation to other words in the OECD MTC and, for the sake of consistency and convenience, this is continued in relation to beneficial ownership.

¹⁵⁶⁰ The term was, however, used in earlier treaties (Oliver (2001) 1 *BTR* 27 28).

¹⁵⁶¹ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 10B–09; Vogel *et al Klaus Vogel on Double Taxation Conventions* 561; Du Toit and Hattingh in *Silke on International Tax* para 9.1. Treaty shopping is defined as follows: “Treaty shopping has been described as the situation where a person who is not entitled to the benefits of a treaty makes use – in the widest meaning of the word – of an individual or of a legal person in order to obtain those treaty benefits that are not available directly” (Larking *IBFD International Tax Glossary* 426). However, according to Schwarz the purpose of the introduction of the beneficial ownership concept is obscure (Schwarz *Schwarz on Tax Treaties* 309).

MTC or in the Commentary and it is rarely defined in actual tax treaties.¹⁵⁶² However, the meaning of the term has been uncertain right from the start.¹⁵⁶³ Until recently, there were no documents (other than the official OECD material, such as the OECD MTC, Commentary and Reports) available to indicate the intended meaning of the term and very little to indicate why this term was chosen.¹⁵⁶⁴ However, according to Du Toit, certain recently released OECD material indicates that “[a]t the very least, though, there is strong evidence that the OECD borrowed the notion of beneficial ownership from the common law states to be used as a treaty concept and there does not appear to be any evidence negating such a view”.¹⁵⁶⁵ Vann has studied these materials extensively and argues that Working Party 27 (who was responsible for the introduction of the term) intended to address only the question of agents and nominees. It never intended to address the problems of conduit and holding companies and the attribution of income.¹⁵⁶⁶ Furthermore, by studying the reports by Working Party 21 (which dealt with abuse of treaties), Vann concludes that there is no historical justification for the view that beneficial ownership deals with conduit companies.¹⁵⁶⁷

The most important reason for the disagreement regarding the meaning of the term is that it is used in Double Taxation Treaties (DTTs) between states with different legal systems, for example, between common law and civil law states. The term is well-known in common law states, but less familiar in civil law states.¹⁵⁶⁸ Yet, even in common law states there seems to be no conclusive and settled definition of the term.¹⁵⁶⁹

It should be borne in mind that in a DTT context, the beneficial owner test is applied by the state of source, according to that state’s law, since it is the state of source that has to decide whether treaty benefits should be granted.¹⁵⁷⁰ In this regard, if South Africa or Canada is the source state, it will have to consider whether a trust, that claims relief in terms of a DTT, will be regarded as the beneficial owner.¹⁵⁷¹ If the United Kingdom is the state of source, it will have to determine whether the trustee, claiming relief in terms of a DTT, can be regarded as the beneficial owner. In general, neither the trustee, nor the trust is taxable in the Netherlands and therefore the beneficial owner requirement will not be applied to either of these in the Netherlands.

The meaning of the term beneficial ownership has elicited much debate over the years and many authors have commented on its meaning. The purpose of the discussion in this chapter is primarily to ascertain whether a trust (or trustee) may be regarded as a beneficial owner. This will be done against the background of an overview of the existing views and case law on the meaning of the term. The chapter starts off by considering some of the difficulties

¹⁵⁶² Panayi *Double Taxation, Tax treaties, Treaty-shopping and the European Community* 44.

¹⁵⁶³ Oliver (2001) 1 *BTR* 27 27; Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* 10B–09; Smit in *Beneficial Ownership: Recent Trends* 60.

¹⁵⁶⁴ Oliver (2001) 1 *BTR* 27 29; Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 327.

¹⁵⁶⁵ Du Toit (2010) 64 *BFIT* 500 503.

¹⁵⁶⁶ Vann (2012) 66 *Sydney Law School: Legal Studies Research Paper* 19.

¹⁵⁶⁷ Vann (2012) 66 *Sydney Law School: Legal Studies Research Paper* 26.

¹⁵⁶⁸ Du Toit (2010) 64 *BFIT* 500 500.

¹⁵⁶⁹ Du Toit (2010) 64 *BFIT* 500 502.

¹⁵⁷⁰ Prebble (2008) VIII *Trusts and Tax Treaties* 75 76. In the same vein, see Avery Jones (1989) 3 *BTR* 65 80.

¹⁵⁷¹ The trust is regarded as a taxpayer in both South Africa and Canada. See chs 3.2.1, 3.4.1 and 6.2.2.2.

surrounding the interpretation of the term, the prime question being whether a domestic law meaning or a meaning in accordance with the context of the DTT should be attached to the term. Next, the OECD Commentary on the meaning of the term is discussed, followed by an examination of the eminent cases pronouncing on its meaning. The views of academic authors are also briefly discussed. An analysis of these sources shows that there are a number of views regarding the meaning of the term: One view is that only agents and nominees are excluded from the beneficial ownership concept. Another view is that other entities should also be excluded from the beneficial owner concept, but the question then becomes how to determine which other entities should be excluded. In this regard, one view focusses on the attributes of ownership (or some of these attributes). Another view states that the term excludes any conduit which, although it is the formal owner, has very narrow powers which render it a mere fiduciary or administrator. It is furthermore uncertain whether the practical (or economic) effect of the transaction should be taken into account, or only the parties' legal obligations. A further view holds that the beneficial ownership requirement functions as a broad anti-avoidance tool and should be interpreted accordingly.

Once these views have been considered, the focus shifts to trusts, starting with a review of the opinions of academic authors on whether a trust (or a trustee) can be a beneficial owner. Following certain selected passages from case law dealing specifically with trusts (or trustees) and the beneficial ownership requirement, the OECD's revised proposals for the amendment of the Commentary in relation to trusts and beneficial ownership are discussed. These perspectives are used to formulate a view on whether a trust(ee) may be regarded as the beneficial owner for purposes of a DTT.

8.2 Difficulties surrounding the interpretation of beneficial ownership

8.2.1 Domestic law meaning or meaning in accordance with the context of the DTT?

The starting point of the debate on the meaning of beneficial ownership is whether it is to be accorded a particular treaty meaning, or whether its meaning is to be determined in terms of domestic law, in accordance with article 3(2) of the OECD MTC. The provisions of article 3(2) were discussed earlier in this dissertation.¹⁵⁷² It is, however, convenient to repeat the text of that provision:

“As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.”

The article therefore provides that an undefined term will have the meaning under the tax laws (or if there is no such meaning in tax law, the meaning under any other law) of the state applying the treaty. If, however, the context requires otherwise, this domestic tax law meaning will not apply.

Assuming for the moment that the domestic law meaning of the state applying the treaty should be applied, a question that arises is whether a state that does not use the term in its

¹⁵⁷² See ch 5.2.6.

domestic law, may define that term; or whether a state that does use the term in its domestic law, may expand that term. This question therefore asks whether states may use the term beneficial ownership to legislate their own anti-avoidance rules.¹⁵⁷³ Academic authors disagree on whether domestic anti-avoidance legislation may be applied to DTTs.¹⁵⁷⁴ The OECD in its Commentary states that domestic anti-avoidance rules are part of the basic domestic rules for determining which facts give rise to tax liability. As these rules are not addressed in DTTs, they are not affected by DTTs. The OECD therefore maintains that there is no conflict between domestic anti-avoidance legislation and tax treaties.¹⁵⁷⁵ The Commentary does, however, point out that countries should carefully observe the specific obligations enshrined in DTTs to relieve double taxation as long as there is no clear evidence that the treaties are being abused.¹⁵⁷⁶ In the new proposed Commentary on beneficial ownership in articles 10, 11 and 12, it is stated that other ways of addressing conduit company and treaty shopping situations, such as anti-abuse provisions in treaties, general anti-abuse rules and substance over form or economic substance approaches, may be used in addition to the beneficial ownership requirement. The beneficial ownership requirement should not be seen as restricting these approaches in any way.¹⁵⁷⁷

Oliver raises a number of arguments to support his view that the domestic law meaning of the term should not be used:¹⁵⁷⁸

- (a) The term beneficial ownership is used in a number of places throughout articles 10, 11 and 12 and not only in sub-article 1. Because the term is used in several different ways in the same article, it is arguable that it was recognised that using a variety of domestic interpretations would be unproductive.
- (b) The Commentary provide some indication of what is meant by the term and it is possible that the domestic law meaning may not correspond with indications in the Commentary.
- (c) Some states do not have a meaning for the term beneficial owner and it is unlikely that the drafters of the OECD MTC would have been unaware of the fact that in some situations the term may have no meaning at all.
- (d) If both contracting states have a meaning for the term, these meanings may differ, resulting a dispute as to whether a person is a beneficial owner.
- (e) A different part of the Commentary to article 11 states that in the OECD references to domestic laws should as far as possible be avoided.

¹⁵⁷³ Oliver (2001) 1 *BTR* 27 43.

¹⁵⁷⁴ Oliver (2001) 1 *BTR* 27 44.

¹⁵⁷⁵ Commentary on the OECD MTC art 1 para 22.1.

¹⁵⁷⁶ Commentary on the OECD MTC art 1 para 22.2.

¹⁵⁷⁷ OECD *OECD Model Tax Convention: Revised Proposal Concerning the Meaning of "Beneficial Owner" in Articles 10, 11 and 12* proposed new Commentary on the OECD MTC art 10 para 12.5. These proposals are dealt with in ch 8.3.

¹⁵⁷⁸ Oliver (2001) 1 *BTR* 27 47–49.

- (f) The term beneficial owner was understood by the drafters to prevent, to some extent at least, treaty shopping. That again suggests the desire, the need and the intention to have a uniform understanding of what the term means.
- (g) The term enterprise is also undefined, but the Commentary makes it clear that the domestic law meaning should be used. This is contrasted to the term beneficial owner where the Commentary is silent on the use of the domestic law meaning, the inference being that the term is intended to have a treaty meaning and not a domestic law meaning.

Baker agrees that the domestic law meaning of the term should not be used and supports the use of an international fiscal meaning.¹⁵⁷⁹ Vogel also argues that the domestic law of the state applying the treaty cannot be used to interpret the term because none of the national systems which he considered offer a precise definition of the term. The term should therefore be “interpreted with reference to the context of the treaty, and particularly with a view to the purpose pursued by the restriction”.¹⁵⁸⁰ It has, indeed, been stated that it is widely accepted that the term should be interpreted in the context of DTTs (and therefore not in terms of domestic law).¹⁵⁸¹

Du Toit contends that in cases where the term does not form part of the domestic law of both contracting states, the domestic law meaning cannot be applied in terms of article 3(2). However, where the term forms part of the domestic law of both states, the domestic law meaning can, arguably, be applied. Nevertheless, even in these cases, it may be argued that the term should be given an international fiscal meaning, because the term has its genesis in DTTs and, thus, the context requires that the domestic law meaning should not apply. He adds that it may not make a big difference whether the domestic law of the states that use this term or the international meaning is applied, since the two meanings may be similar.¹⁵⁸²

The current OECD Commentary, which states that the term is not used in a narrow technical sense, but that it should rather be understood in its context and in light of the object and purposes of the Convention, suggests that an international fiscal meaning should be used.¹⁵⁸³ The OECD’s proposed amendments to the Commentary on beneficial ownership also indicate that the domestic law meaning should be disregarded and that an interpretation in accordance with the context of the DTT should be followed.¹⁵⁸⁴

¹⁵⁷⁹ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* 10B–13–10B–14.

¹⁵⁸⁰ Vogel *et al Klaus Vogel on Double Taxation Conventions* 562.

¹⁵⁸¹ Danon *Switzerland’s Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 329. Other academic authors who support the use of an international fiscal meaning (as opposed to a domestic tax law meaning) include Avery Jones (1989) 3 *BTR* 65 70; Jezzi (2010) 64 *BFIT* 253 254; Danon (2011) 65 *BFIT* 437 438; De Broe *International Tax Planning and Prevention of Abuse: A Study under Domestic Tax Law, Tax Treaties and EC Law In Relation to Conduit and Base Companies* 662–675; Oguttu (2007) XL *CILSA* 237 251 and Smit in *Beneficial Ownership: Recent Trends* 75. However, Schwarz is of the view that the domestic law meaning of the term should be applied, at least where United Kingdom tax is concerned (Schwarz *Schwarz on Tax Treaties* 310).

¹⁵⁸² Du Toit *Beneficial Ownership of Royalties in Bilateral Tax Treaties* 177–178.

¹⁵⁸³ Eg Commentary on the OECD MTC art 10 para 12.1. Danon (2011) 65 *BFIT* 437 438.

¹⁵⁸⁴ Collier (2011) 6 *BTR* 684 701.

Case law also indicates that an international fiscal meaning should be attached to the term. In the United Kingdom case of *Indofood*, the court confirmed the view that the term beneficial ownership should be given “an international fiscal meaning not derived from the domestic laws of contracting states”.¹⁵⁸⁵ From the Canadian decision in *Alberta Power (2000) Inc v Her Majesty the Queen* the impression is gained that there is no distinction between the meaning of beneficial ownership in terms of domestic legislation and in terms of a DTT.¹⁵⁸⁶ In the Canadian *Prévost* decision, the court stated that its formulation was in accordance with the OECD Commentary and the Conduit Companies Report.¹⁵⁸⁷ It is submitted that this statement indicates the court’s intention to use an international fiscal meaning, rather than a domestic law meaning.¹⁵⁸⁸ According to Smit,¹⁵⁸⁹ the Netherlands Supreme Court interpreted the term beneficial owner in an autonomous fashion in the “market maker” case.¹⁵⁹⁰

The following paragraphs survey the view of each of the states discussed in this dissertation regarding the question whether the domestic law meaning or the international fiscal meaning of the term should be used. For the sake of completeness, the domestic law meaning, if any, in the relevant states is briefly outlined.

8.2.1.1 South Africa

There is no South African case dealing specifically with the meaning of the term in a DTT.¹⁵⁹¹ Furthermore, the term is not defined in any of the treaties entered into by South Africa. For these reasons, Du Toit and Hattingh suggest that “for purposes of determining the meaning of beneficial ownership for purposes of double tax conventions to which South Africa is a party the international tax language meaning of the term should be adopted”.¹⁵⁹² Olivier and Honiball agree, stating that South Africa, by concluding DTTs containing the term, knowing that no domestic tax law meaning exists, intended that an international fiscal meaning must apply.¹⁵⁹³

Regarding the meaning of the term in South African domestic law, the first point to recognise is that South Africa is regarded as a mixed legal system, not a common law system.¹⁵⁹⁴ Hence, the concept of beneficial ownership, as found in states with a common law system, is not embedded in the South African legal system.¹⁵⁹⁵ It is therefore necessary

¹⁵⁸⁵ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] EWCA Civ 158 para 42. This point was supported by a Danish case (Hansen *et al* (2013) 67 *BFIT* 192 para 3.2). According to Baker, the court in the *Indofood* case was considering the meaning of beneficial owner as applicable to all states, and not just to Indonesia (Baker in *Beneficial Ownership: Recent Trends* 32).

¹⁵⁸⁶ *Alberta Power (2000) Ltd v Her Majesty the Queen* 2009 TCC 412 para 67.

¹⁵⁸⁷ *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57 para 14.

¹⁵⁸⁸ Some authors claim that it is not clear whether the court adopted a domestic law meaning, some sort of internationally accepted meaning or a combination of both (De Broe *et al* (2011) 65 *BFIT* 375 388). Others state that the court applied the meaning under Canadian law (Arnold in *Beneficial Ownership: Recent Trends* 48).

¹⁵⁸⁹ Smit in *Beneficial Ownership: Recent Trends* 65.

¹⁵⁹⁰ *Hoge Raad* 6 April 1994 No 28 638 BNB 1994/217. This case is often referred to as the “market maker” case.

¹⁵⁹¹ Du Toit and Hattingh in *Silke on International Tax* para 9.1.

¹⁵⁹² Du Toit and Hattingh in *Silke on International Tax* para 9.4.

¹⁵⁹³ Olivier and Honiball *International Tax: a South African Perspective* 548.

¹⁵⁹⁴ See ch 2.2.4.

¹⁵⁹⁵ Olivier and Honiball *International Tax: a South African Perspective* 543.

to examine specific areas of the law (statute and cases) to determine whether the concept of beneficial ownership has a meaning in South African law.

From a trust law perspective, it is important to note again that the dual ownership concept does not form part of South African law. The trustees are the legal owners of the trust property, but they have no beneficial interest in it. They are, however, bound to hold and apply the trust property for the benefit of a person(s) or for some other purpose. The terms beneficial owner and legal owner are sometimes used in relation to a beneficiary and trustee respectively,¹⁵⁹⁶ but it is submitted that these terms are used to explain the relationship between the parties and not to describe different types of ownership.¹⁵⁹⁷ It seems as though Du Toit and Hattingh support this point when they state that the distinction between legal and beneficial ownership in a trust context is “a description of the legal situation”, but that the parties’ legal rights and duties (and therefore the legal consequences) are not determined by the use of these terms, but rather by the relevant trust deed.¹⁵⁹⁸

Du Toit and Hattingh also examine the use of the term beneficial owner in cases¹⁵⁹⁹ dealing with the procedural enforcement of the rights of principals of nominee shareholders. These principals are sometimes referred to as beneficial owners of the shares. The authors state that:

“The conclusion to be drawn from the authorities is that the legal consequences of using beneficial ownership in the descriptive sense encountered in *Ocean Commodities* and *Oakland Nominees* is only procedural in nature. At most, one can say that a ‘beneficial owner’ of shares have a *quasi* vindicatory action in law that operates against not only the nominee and the company in which the shares are held by the nominee, but also against third parties that seek to claim entitlement to those shares. And this is really the only similarity with a real right that one can identify. It is clear from the court’s reasoning that, apart from the procedural rights of a shareholder that makes use of a nominee, the description of ‘beneficial owner of shares’ designate only a binary situation because it ‘denote[s] the person in whom, as between himself and the registered shareholder, the benefit of the bundle of rights constituting the share vests’. In all other relevant respects, one must conclude that beneficial ownership is only a description of situations involving personal rights and has no independent legal meaning.”¹⁶⁰⁰

The authors further examine South African tax statutes in order to determine whether a South African meaning of the term can be found. Although the Securities Transfer Tax Act refers to the term, it is not defined in that Act. The Uncertified Securities Tax Act, which did contain a definition of the term, has been repealed. Therefore, these two statutes cannot be of assistance in determining the meaning of the term. The Income Tax Act now contains a definition of the term beneficial owner for purposes of the dividends tax. It reads that the beneficial owner “means the person entitled to the benefit of the dividend attaching to a

¹⁵⁹⁶ See eg *Yarram Trading CC t/a Tijuana Spur v ABSA Bank Ltd* 2007 2 SA 570 (SCA).

¹⁵⁹⁷ See ch 2.2.4 for a detailed discussion of the ownership of trust assets.

¹⁵⁹⁸ Du Toit and Hattingh in *Silke on International Tax* para 9.10.

¹⁵⁹⁹ *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 1 SA 441 (A) and *Standard Bank of South Africa Ltd v Ocean Commodities Inc* 1983 1 SA 276 (A).

¹⁶⁰⁰ Du Toit and Hattingh in *Silke on International Tax* par 9.10.

share”.¹⁶⁰¹ According to Du Toit and Hattingh,¹⁶⁰² it may be argued that this definition has no effect on treaties that were concluded prior to the introduction of the dividends tax and that contain an article 3(2) patterned on the pre-1995 version of that article in the OECD MTC. The pre-1995 version of that article did not refer to the domestic law at the time that the DTT is applied and it is often argued (but not universally accepted) that in such a case, the domestic law meaning of the term at the time that the treaty was entered into should apply.¹⁶⁰³ These authors also argue that it would be undesirable for the definition of beneficial owner, for the dividends tax purposes, to be used in relation to dividends under the treaty, whilst other definitions are used in relation to interest and royalties under the same treaty.¹⁶⁰⁴ This point is reinforced if one takes into account that the provision containing the dividends tax definition specifically states that it applies only to the part of the Income Tax Act relating to the dividends tax.¹⁶⁰⁵

The Companies Act does not use the term beneficial owner. Rather, it uses the term “beneficial interest” and provides that, to the extent that a company’s Memorandum of Incorporation provides otherwise, a company’s issued securities may be held by, and registered in the name of, one person for the beneficial interest of another person.¹⁶⁰⁶ The Companies Act defines the term “beneficial interest” as follows:

“[W]hen used in relation to a company’s securities, [it] means the right or entitlement of a person, through ownership, agreement, relationship or otherwise, alone or together with another person to –

- (a) receive or participate in any distribution in respect of the company’s securities;
- (b) exercise or cause to be exercised, in the ordinary course, any or all of the rights attaching to the company’s securities; or
- (c) dispose or direct the disposition of the company’s securities, or any part of a distribution in respect of the securities,

but does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Investment Schemes Act, 2002 (Act No. 45 of 2002).”¹⁶⁰⁷

In addition, the Companies Act lists a number of circumstances under which a person will be regarded as having a beneficial interest in a security of a public company.¹⁶⁰⁸ Certain disclosure requirements are imposed in respect of securities in which a beneficial interest is held¹⁶⁰⁹ and other matters are regulated.¹⁶¹⁰

¹⁶⁰¹ Income Tax Act 58 of 1962 s 64D.

¹⁶⁰² The authors made their comments before the dividends tax came into force, but it is submitted that their comments are still valid as the definition of beneficial owner was not amended since their comments were made and the structure of the tax did not change substantially either.

¹⁶⁰³ Du Toit and Hattingh in *Silke on International Tax* para 9.11.

¹⁶⁰⁴ Du Toit and Hattingh in *Silke on International Tax* para 9.13.

¹⁶⁰⁵ Income Tax Act 58 of 1962 s 64D. Support for this argument may be found in Olivier and Honiball *International Tax: a South African Perspective* 544. These authors state that the concept of beneficial owner is not generally found in statute law despite the inclusion of a definition for purposes of the dividends tax.

¹⁶⁰⁶ Companies Act 71 of 2008 s 56(1).

¹⁶⁰⁷ Companies Act 71 of 2008 s 1.

¹⁶⁰⁸ Companies Act 71 of 2008 s 56(2); Cassim *et al Contemporary Company Law* 251.

¹⁶⁰⁹ Companies Act 71 of 2008 ss 56(3)–(7).

It is submitted that the definition in the Companies Act cannot be considered the South African domestic law meaning of the term for purposes of applying an article such as article 3(2) of the OECD MTC. The obvious formal point to make is that the terms (beneficial *owner* and beneficial *interest*) are not identical and may indicate that the beneficial owner concept does not form part of the South African Companies Act. A stronger argument is that the Companies Act itself states that the definition of beneficial interest applies only for the purposes of that Act. In situations in which the Companies Act does not apply, for example, where there are no securities involved (such as a back-to-back loan, or a royalty structure) the definition will not apply and even if it is applied, may be very difficult to apply sensibly. Furthermore, the definition in the Companies Act clearly relates to the beneficial interest in a security and not the beneficial interest in the income from the share (that is, the dividend). In addition, the point made by Du Toit and Hattingh in respect of DTTs patterned on the pre-1995 OECD Model, applies equally to the Companies Act definition.

From the above it is concluded that there is no meaning in South African law that may be used for purposes of a domestic law meaning of the term as required by article 3(2) of the OECD MTC. If this conclusion is correct, then, applying Du Toit's view that where the term does not form part of the domestic law of both contracting states, the domestic law meaning cannot be applied in terms of article 3(2), it may be argued that an international fiscal meaning will always be applied in treaties to which South Africa is a party.

8.2.1.2 United Kingdom

Her Majesty's Revenue and Customs (HMRC) is of the view that the meaning of beneficial ownership "is not limited to the meaning that it might have under the domestic law of a state (such as in the context of UK trust law), rather in the context of treaties it should be given an 'international fiscal meaning'".¹⁶¹¹ It is also submitted that the *Indofood*¹⁶¹² decision, confirming that an international fiscal meaning should be given to the term, will have strong persuasive value in the United Kingdom. However, Schwarz argues that this decision was based on what an Indonesian tax court would have decided in circumstances where there was no legal meaning of the term and that the court therefore "had no choice but to rely on international interpretative techniques".¹⁶¹³

Relying on the *Indofood* case, HMRC states that if a person does not have the full privilege to directly benefit from the income, he or she must be under an obligation to pass that income on to another person. This obligation might be found in legal documents, but also by looking at the commercial and practical substance of an arrangement. All aspects of an arrangement should therefore be examined and not just its legal form. If an obligation to pass income on exists, it is irrelevant that the character of the income has changed. Furthermore, the fact that income is not passed on immediately, does not indicate that the recipient is the beneficial owner. When considering whether there is an obligation to pass on an item of

¹⁶¹⁰ Eg Companies Act 71 of 2008 ss 56(8)–(11)

¹⁶¹¹ Her Majesty's Revenue and Customs *International Manual* para INTM504030.

¹⁶¹² *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] EWCA Civ 158. This case is discussed in greater detail below.

¹⁶¹³ Schwarz *Schwarz on Tax Treaties* 310–311.

income, it should be borne in mind that the obligation must be specific to the payment received.¹⁶¹⁴

Du Toit and Hattingh quote the following passages from the case law in the United Kingdom to sum up the meaning of the term in the United Kingdom.¹⁶¹⁵

In *Ayerst (Inspector of Taxes) v C&K (Construction) Ltd* the court held that

“the concept of legal ownership of property, which did not carry with it the right of the owner to enjoy the fruits of it or dispose of it for his own benefit, owed its origin to the Court of Chancery. The archetype is the trust. The ‘legal ownership’ of the trust property is in the trustee, but he holds it not for his own benefit but for the benefit of the *cestui que* trustent or beneficiaries. On the creation of a trust in the strict sense as it was developed by equity the full ownership in the trust property was split into two constituent elements, which became vested in different persons: the ‘legal ownership’ in the trustee, and what came to be called the ‘beneficial ownership’ in the *cestui que* trust.”¹⁶¹⁶

In *Wood Preservation Ltd v Prior (Inspector of Taxes)* the court stated that beneficial ownership meant

“[a]n ownership which is not merely the legal ownership by the mere fact of being on the register but the right at least to some extent to deal with the property as your own.”¹⁶¹⁷

Regarding beneficial ownership, it was stated in *J Sainsbury plc v O’Connor (Inspector of Taxes)*:

“It means ownership for your own benefit as opposed to ownership as trustee for another. It exists either where there is no division of legal and beneficial ownership or where legal ownership is vested in one person and the beneficial ownership ... in another.”¹⁶¹⁸

Other authors¹⁶¹⁹ refer also to *Parway Estates Ltd v IRC*,¹⁶²⁰ where a purchaser of shares in an unconditional contract for the sale of shares was held to be the equitable owner of the shares after the execution of the contract, but before completion thereof. In *English Sewing Cotton Company Ltd v IRC*¹⁶²¹ the court held that a mortgagor remained the beneficial owner of the mortgaged property.

After considering the relevant case law, Roland concludes as follows regarding the meaning of beneficial ownership in the United Kingdom:

¹⁶¹⁴ Her Majesty’s Revenue and Customs *International Manual* para INTM504030.

¹⁶¹⁵ Du Toit and Hattingh in *Silke on International Tax* para 9.5.

¹⁶¹⁶ *Ayerst (Inspector of Taxes) v C&K (Construction) Ltd* [1975] STC 345 HL 349.

¹⁶¹⁷ *Wood Preservation Ltd v Prior (Inspector of Taxes)* (1968) 45 TC 112 CA 132–133.

¹⁶¹⁸ *J Sainsbury plc v O’Connor (Inspector of Taxes)* [1991] STC 318 CA 330.

¹⁶¹⁹ Schwarz *Schwarz on Tax Treaties* 314–315 and Rowland (1997) 3 *BTR* 178 184–185.

¹⁶²⁰ *Parway Estates Ltd v IRC* (1958) 45 TC 135.

¹⁶²¹ *English Sewing Cotton Company Ltd v IRC* [1947] 1 All ER 679.

“It is reasonably clear that this is the bundle of rights required to allow enjoyment of an asset by the owner but falling short of, or distinct from, legal title. It is generally where the real value in an asset lies even though a transfer of the legal title will be required in some cases for official recognition of ownership. It is less clear whether beneficial ownership is the same as equitable ownership.”¹⁶²²

8.2.1.3 Canada

It is submitted that the Canadian Federal Court of Appeal, in *Prévost*, by stating that its formulation of the beneficial ownership test was in accordance with the OECD Commentary and the Conduit Companies Report,¹⁶²³ indicates the court’s intention to use an international fiscal meaning, rather than a domestic law meaning.

The Income Tax Act¹⁶²⁴ does not define the term beneficial ownership, a point acknowledged by the Federal Court of Appeal in *Prévost*.¹⁶²⁵ According to some authors, there is no domestic tax law meaning of the term.¹⁶²⁶ Brown argues convincingly that the terms beneficial owner, beneficial ownership or beneficially owned may have multiple meanings in the Income Tax Act, or the meaning may change depending on the provision at issue.¹⁶²⁷ Brender states that there is no consensus on the meaning of beneficial ownership in common law.¹⁶²⁸

In *Alberta Power (2000) Ltd v Her Majesty the Queen*,¹⁶²⁹ the court cited a number of cases pronouncing on the meaning of beneficial ownership. For example, in *Williams v R*¹⁶³⁰ the court stated that the term should be given its ordinary meaning consistent with the scheme of the Act and quoted the dictionary meaning of the term. In *Larose (M) v MNR* the court held the meaning of the term to be as follows:

“A property is deemed to be beneficially owned when one person assesses the three attributes of the ownership of property (*usus, fructus, abusus*) or when a property is subject to a usufruct, an emphyteutic lease or a servitude.”¹⁶³¹

Du Toit refers to a number of court cases to illustrate the meaning of the term in Canadian law:

“Couture C.J. in *Fortin & Moreau Inc. c. Ministre du Revenu national*, describes the beneficial owner of property as the one to whom ownership belongs subsequent to a transaction (when the purchaser has all incidents of title, such as possession, use and risk, although legal title may remain in the vendor as security), but who will receive title to the property at a later date. According to Marceau J.A. in *Mount Royal/Walsh*

¹⁶²² Rowland (1997) 3 BTR 178 186.

¹⁶²³ *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57 para 14.

¹⁶²⁴ Income Tax Act RSC 1985 (5th supp) ch 1.

¹⁶²⁵ *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57 para 8.

¹⁶²⁶ Bernstein (2011) 63 *Thoughts on the OECD Discussion Paper on Beneficial Ownership* 49 49.

¹⁶²⁷ Brown (2003) 51 *Canadian Tax Journal* 402

¹⁶²⁸ Brender (2003) 51 *Canadian Tax Journal* 311 315.

¹⁶²⁹ *Alberta Power (2000) Ltd v Her Majesty the Queen* 2009 TCC 412.

¹⁶³⁰ *Williams v R* 2005 TCC 558.

¹⁶³¹ *Larose (M) v MNR* [1992] 2 CTC 2339.

Inc. v Ship 'Jensin Star' et al, the expression 'beneficial owner' serves to include someone who stands behind the registered owner in situations where the latter functions merely as an intermediary, like a trustee, a legal representative, or an agent."¹⁶³²

In terms of these cases, the attributes of ownership determine who the beneficial owner is. Furthermore, these cases suggest that a trustee will not usually be regarded as the beneficial owner.

8.2.1.4 The Netherlands

The Netherlands government is of the view that beneficial ownership should be given a meaning in terms of domestic law.¹⁶³³ This may be contrasted to the view expressed by Smit that the Dutch Supreme Court in the "market maker" case¹⁶³⁴ interpreted the term in an autonomous fashion, because it referred neither to domestic law, nor to the relevant Commentary.¹⁶³⁵

Since 2001, the *Wet op de dividendbelasting* contains a negative definition of the term beneficial owner.¹⁶³⁶ The definition is summarised by Smit as follows:

"The receiver of the dividends cannot be regarded as the beneficial owner if the following conditions are met:

- the recipient of the dividends entered into a set of transaction with the original shareholder;
- as part of a sequence of transactions whereby the original shareholder receives proceeds replacing the dividends;
- the recipient of the dividends is entitled to a reduced rate of Netherlands dividend withholding tax, i.e. is in an improved Netherlands dividend withholding tax position; and

¹⁶³² Du Toit *Beneficial Ownership of Royalties in Bilateral Tax Treaties* 129–130. Original footnotes were omitted in this quotation.

¹⁶³³ De Broe *et al* (2011) 65 *BFIT* 375 388.

¹⁶³⁴ *Hoge Raad* 6 April 1994 No 28 638 BNB 1994/217.

¹⁶³⁵ Smit in *Beneficial Ownership: Recent Trends* 65.

¹⁶³⁶ *Wet op de dividendbelasting* 1965 s 4(7) reads as follows: "Voor het achterwege laten van de inhouding van dividendbelasting ingevolge dit artikel, een teruggaaf van dividendbelasting ingevolge artikel 10, alsmede het achterwege laten dan wel een vermindering of teruggaaf van dividendbelasting ingevolge de Belastingregeling voor het Koninkrijk, de Belastingregeling voor het land Nederland of een door Nederland gesloten verdrag ter voorkoming van dubbele belasting, wordt niet als uiteindelijk gerechtigde beschouwd degene die in samenhang met de genoten opbrengst een tegenprestatie heeft verricht als onderdeel van een samenstel van transacties waarbij aannemelijk is dat: a. de opbrengst geheel of gedeeltelijk direct of indirect ten goede is gekomen aan: 1. een natuurlijke persoon of een rechtspersoon ten aanzien van wie inhouding niet achterwege mag blijven, terwijl dit ten aanzien van degene die de tegenprestatie heeft verricht wel mag, of 2. een natuurlijke persoon of rechtspersoon die in mindere mate gerechtigd is tot vermindering of teruggaaf van dividendbelasting dan degene die de tegenprestatie heeft verricht; en b. deze natuurlijke persoon of rechtspersoon een positie in aandelen, winstbewijzen of geldleningen als bedoeld in artikel 10, eerste lid, onderdeel d, van de Wet op de vennootschapsbelasting 1969 op directe of indirecte wijze behoudt of verkrijgt die vergelijkbaar is met zijn positie in soortgelijke aandelen, winstbewijzen of geldleningen voorafgaand aan het moment waarop het samenstel van transacties een aanvang heeft genomen."

- the original shareholder (directly or indirectly) hold or acquires an interest in the distributing entity that is equal or almost entirely equal to the interest it held before the set of transactions.”¹⁶³⁷

However, Van Weeghel and De Boer question whether a Dutch court will apply this statutory definition of beneficial owner in a dividend stripping situation, because DTTs in the Netherlands supersede domestic laws that are in contravention of the treaty provisions.¹⁶³⁸ This sentiment is echoed by Smit.¹⁶³⁹

The “market maker” case suggests that if a person has the free disposal of the income and does not act as agent or nominee for another, that person will be the beneficial owner for purposes of a DTT.¹⁶⁴⁰ It is disputed in the academic literature whether this case restricts the beneficial owner concept to agents and nominees (that is, a strict interpretation) or whether it may also include other relationships as well (that is, a more economic approach).¹⁶⁴¹ In any event, if the statutory definition of beneficial owner were to apply to the facts of the “market maker” case, the stockbroker would not have qualified as the beneficial owner.¹⁶⁴²

8.2.2 Other difficulties

It is uncertain whether the term serves as an attribution rule or as an anti-avoidance rule. In articles 10 and 11 the term is used as an anti-avoidance rule, but in article 12 it is used as an attribution rule. It is an open question whether the term will have different functions in different articles, or whether the term simply performs both functions in article 12.¹⁶⁴³

Articles 10 and 11 use the words “paid to” and “derived by” in addition to the term beneficial owner. The question that arises is whether a treaty claimant must show that income was both paid to (or derived by) him or her and that he or she is the beneficial owner. It could even be argued that it is enough for him or her to show that he or she is the beneficial owner.¹⁶⁴⁴

8.3 The OECD Commentary on the meaning of beneficial ownership

In 1977, when the beneficial ownership requirement was added, the Commentary provided that “the limitation of tax in the State of source is not available when an intermediary, such as an agent or nominee, is interposed between the beneficiary and the payer, unless the beneficial owner is a resident of the other Contracting State”.

The Conduit Companies Report in 1986 elaborated on the meaning of the term, stating that:

¹⁶³⁷ Smit in *Beneficial Ownership: Recent Trends* 74.

¹⁶³⁸ Van Weeghel and De Boer (2006) 60 *BFIT* 358 364.

¹⁶³⁹ Smit in *Beneficial Ownership: Recent Trends* 74–75.

¹⁶⁴⁰ *Hoge Raad* 6 April 1994 No 28 638 BNB 1994/217. This case is discussed in greater detail in ch 8.4.

¹⁶⁴¹ Smit in *Beneficial Ownership: Recent Trends* 66.

¹⁶⁴² Smit in *Beneficial Ownership: Recent Trends* 74. He adds that the statutory definition is much broader in scope than the one given by the Dutch Supreme Court.

¹⁶⁴³ Wheeler (2011) 3 *World Tax Journal* 247 257.

¹⁶⁴⁴ Wheeler (2011) 3 *World Tax Journal* 247 257–258. In a different contribution Wheeler opines that “The role of the beneficial ownership concept is clearer; it is not an attribution rule as such, but has the function of denying treaty benefits to persons whose connection with the income is not substantial enough” (Wheeler in *Cahiers de Droit Fiscal International: Conflicts in the Attribution of Income to a Person* 57).

“[t]he Commentaries mention the case of a nominee or agent. The provisions would, however, apply also to other cases where a person enters into contracts or takes over obligations under which he has a similar function to those of a nominee or an agent. Thus a conduit company can normally not be regarded as the beneficial owner if, though the formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties (most likely the shareholders of the conduit company).”¹⁶⁴⁵

Du Toit questions the role and place of this report in the interpretation of the meaning of the term beneficial owner, as this report was only adopted almost ten years after the inclusion of the term in the OECD MTC. However, he comments that the significance of the report lies in the extension of the persons excluded as beneficial owners, to the formal owners of assets, who have very narrow powers that would reduce them to mere fiduciaries or administrators acting on account of the interested parties.¹⁶⁴⁶ Considering the whole of the Conduit Companies Report, Collier avers that there seemed, at that stage, “to be no wish or attempt to interpret the beneficial ownership test as having a broad anti-treaty shopping function”.¹⁶⁴⁷

The current wording of the Commentary, which was inserted in 2003, reads as follows:

“12. The requirement of beneficial ownership was introduced in paragraph 2 of Article 10 to clarify the meaning of the words ‘paid ... to a resident’ as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over dividend income merely because that income was immediately received by a resident of a State with which the State of source had concluded a convention. The term beneficial owner is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

12.1 Where an item of income is received by a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on

¹⁶⁴⁵ OECD *Double Tax Conventions and the Use of Conduit Companies* para 14(b). Other OECD Reports also use the term beneficial owner. The Partnership Report briefly discusses whether certain partnerships will be beneficial owners (The OECD *The Application of The OECD Model Tax Convention to Partnerships* paras 54, 61, 65, 71, 73 and 126) and the CIV Report discusses beneficial ownership in the context of collective investment vehicles (OECD *R(24). The granting of treaty benefits with respect to the income of collective investment vehicles* paras 31–52). According to Collier neither of these reports add much to clarify the meaning of beneficial ownership (Collier (2011) 6 *BTR* 684 689–692). This point is supported by the absence of these two reports from Du Toit’s summary of events that are considered as important developments with regard to the meaning of beneficial ownership (Du Toit (2010) 64 *BFIT* 500). However, Vann points out that the Partnership Report used the beneficial ownership concept to try to resolve conflicts of attribution. He adds that this was never the purpose of the beneficial ownership concept and that a solution to the problem could have been reached without reference to beneficial ownership (Vann (2012) 66 *Sydney Law School: Legal Studies Research Paper* 31). Regarding the CIV Report, Vann points out that if the proposals contained in the Report are to be regarded as a general test for beneficial ownership, it could lead to “silly” results (Vann (2012) 66 *Sydney Law School: Legal Studies Research Paper* 33).

¹⁶⁴⁶ Du Toit (2010) 64 *BFIT* 500 503. See also Collier (2011) 6 *BTR* 684 688 and Jezzi (2010) 64 *BFIT* 253 253.

¹⁶⁴⁷ Collier (2011) 6 *BTR* 684 688.

account of the status of the immediate recipient of the income as a resident of the other Contracting State. The immediate recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence. It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled 'Double Taxation Conventions and the Use of Conduit Companies' concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties."¹⁶⁴⁸

Commenting on the above passage in the Commentary, Du Toit and Hattingh point out that it is unclear what is meant by "conduit". Furthermore, the Commentary does not describe the criteria to determine whether a "benefit" has been received or what the "practical matters" are which are to be considered.¹⁶⁴⁹ Du Toit and Hattingh add that the reference to "as a practical matter" did not appear in the Commentary before 2003, nor in the Conduit Companies Report. They regard this phrase as important as it relates to "whether beneficial ownership is a legal as opposed to a practical or substance test".¹⁶⁵⁰ Panayi has no doubts that the Commentary follows a "substance over form" approach, using an economic test.¹⁶⁵¹ Smit also views the Commentary as supporting a broader, economic interpretation of the term.¹⁶⁵² However, Collier queries whether the 2003 amendment to the Commentary introduced a "materially different standard". He argues that the introduction of an economic test would have required a clearer explanation, in the light of the wording of the Commentary as it read before and, furthermore, that a wide economic test would have rendered the references to "nominee" and "agent" irrelevant.¹⁶⁵³ Ward states that the interpretation suggested in the Commentary may be contrary to the Vienna Convention, which provides that the "ordinary meaning" of words should be determined and not the intention of the parties.¹⁶⁵⁴

According to Du Toit and Hattingh, the statement in the Commentary that the term should be interpreted in light of the object and purposes of the Convention, which include the prevention of fiscal evasion and avoidance, is also new.¹⁶⁵⁵ It has been suggested that the

¹⁶⁴⁸ Commentary on the OECD MTC art 10 para 12–12.1. The Commentary on art 10 is used as an example here, although arts 11 and 12 contain similar commentary.

¹⁶⁴⁹ Collier (2011) 6 BTR 684 690.

¹⁶⁵⁰ Du Toit and Hattingh in *Silke on International Tax* para 9.5.

¹⁶⁵¹ Panayi *Double Taxation, Tax treaties, Treaty-shopping and the European Community* 45.

¹⁶⁵² Smit in *Beneficial Ownership: Recent Trends* 60.

¹⁶⁵³ Collier (2011) 6 BTR 684 690.

¹⁶⁵⁴ Ward *Access to Tax Treaty Benefits: Research Report Prepared for the Advisory Panel on Canada's System of International Taxation* 9.

¹⁶⁵⁵ Du Toit and Hattingh in *Silke on International Tax* 9.5; Collier (2011) 6 BTR 684 690; Duff in *Beneficial Ownership: Recent Trends* 1 and Smit in *Beneficial Ownership: Recent Trends* 60.

OECD, through the change in the Commentary, expanded the meaning of beneficial ownership to address an unspecified anti-avoidance concern.¹⁶⁵⁶

Vann argues that the Commentary tries to use the object and purpose of a DTT to combine agents/nominees and conduit companies, but that the policy behind each of these differs. More specifically, he argues that the policy behind conduit companies would, on a strict view, require that no juristic person could ever be a beneficial owner, since all juristic persons act as a conduit for individuals who ultimately receive the benefit of the income. This view would entail that beneficial ownership be interpreted to mean the ultimate economic owner, but that this had never been the intended meaning of the term. He continues:

“The remedy which immediately follows taken out of the conduit company report does not match the policy asserted as it is much narrower in effect, similarly as for the different policy asserted in the conduit companies report. The problem of linking broad policies with tests that are much narrower in operation is that readers may come away with different messages which clearly is what has happened. In particular tax administrations seem to have focused on the asserted policy, not the much narrower test applicable to conduits.”¹⁶⁵⁷

The United Kingdom court in *Indofood*¹⁶⁵⁸ and the Canadian court in *Prévost*¹⁶⁵⁹ referred to this version of the Commentary, even though the actual DTTs relevant in those cases were entered into before these amendments to the Commentary were introduced.¹⁶⁶⁰

In April 2011 the OECD released a discussion document regarding the meaning of beneficial ownership in the OECD MTC¹⁶⁶¹ and, after receiving comments on the document, released a revised proposal in October 2012.¹⁶⁶² The proposed amendments to the Commentary on article 10 are included in an annexure to this chapter.

Commenting on these proposed changes, Collier indicates that the OECD is signalling with its proposed amendments in paragraph 12.1 that, applying article 3(2), a treaty-based interpretation of the term should be followed, rather than an interpretation based on the relevant domestic law.¹⁶⁶³ Danon commends the proposed amendments to article 12.4, saying that it confirms that the test of beneficial ownership should be based solely on the ownership attributes of the recipient of the income. However, he argues that the reference to the recipient’s right to use and enjoy the income is misleading. He contends that the

¹⁶⁵⁶ Watson and Baum (2012) 60 *Canadian Tax Journal* 149 152.

¹⁶⁵⁷ Vann (2012) 66 *Sydney Law School: Legal Studies Research Paper* 30.

¹⁶⁵⁸ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] EWCA Civ 158. This case is discussed in greater detail in ch 8.4.

¹⁶⁵⁹ *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57. This case is discussed in greater detail in ch 8.4.

¹⁶⁶⁰ Du Toit (2010) 64 *BFIT* 500 504.

¹⁶⁶¹ OECD *Clarification of the Meaning of “Beneficial Owner” in the OECD Model Tax Convention: Discussion Draft*.

¹⁶⁶² OECD *OECD Model Tax Convention: Revised Proposal Concerning the Meaning of “Beneficial Owner” in Articles 10, 11 and 12*. The OECD’s Committee on Fiscal Affairs invited comment on this revised proposal by 15 December 2012. These comments have been published, but the OECD has not released any further documents.

¹⁶⁶³ Collier (2011) 6 *BTR* 684 701. Although Collier’s comments are based on the April 2011 draft, it is submitted that these comments hold true for the October 2012 draft as well.

element of control over the attribution of income, and not the use and enjoyment thereof, is the crucial test. He therefore suggests that the latter element should be deleted from the definition of beneficial owner.¹⁶⁶⁴ He also criticises the proposal for its failure to adequately address the issue of income attributed to a person for tax purposes, but who may not have any ownership attributes.¹⁶⁶⁵

What does one conclude from the review of the OECD's Commentary regarding beneficial ownership? The Commentary has certainly been expanded from the one sentence added in 1977 and it seems that the meaning that the OECD attaches to the term has expanded along with it. For example, the Commentary did not initially indicate whether the domestic law meaning or the international fiscal meaning of the term should be used. Now especially the proposed Commentary suggests strongly that an international fiscal meaning should be used. What has remained constant, though, is that agents and nominees do not qualify as beneficial owners. The prominent cases on beneficial owner have referred to the OECD Commentary, indicating the importance of the Commentary in determining the meaning of the term. It is submitted that the Commentary offers an international fiscal meaning of the term. Whether the courts will apply such a meaning, depends on the view that a court takes of the role and status of the Commentary.

8.4 Case law on the meaning of beneficial ownership

Du Toit suggests that the main issue regarding the meaning of beneficial ownership is whether a legal, as opposed to a factual or economic substance test, should be applied.¹⁶⁶⁶ This question should be borne in mind when the central cases on the meaning of beneficial ownership are discussed.¹⁶⁶⁷

¹⁶⁶⁴ Danon (2011) 65 *BFIT* 437 439. Although Danon's comments were made on the OECD's April 2011 Discussion Draft, it is submitted that those referred to in this dissertation are equally relevant to the October 2012 version.

¹⁶⁶⁵ Danon (2011) 65 *BFIT* 437 440.

¹⁶⁶⁶ Du Toit (2010) 64 *BFIT* 500 501.

¹⁶⁶⁷ There have been other cases regarding beneficial ownership than the ones discussed in this dissertation. Du Toit and Hattingh list a number of these decisions, but are of the view that the *Hoge Raad's* decision discussed in this paragraph, *Indofood* and *Prévost* are the most important decisions regarding the meaning of the term (Du Toit and Hattingh in *Silke on International Tax* para 9.6). In a separate contribution Du Toit again highlights these cases as the most influential, stating that "[i]n the search for a uniform international tax meaning preference should be given to cases where there was a proper analysis of the meaning of the term, where all the facts were clear and where the decision of the court was not tainted by domestic tax law considerations" (Du Toit (2010) 64 *BFIT* 500 501). Since the publication of Du Toit and Hattingh's contribution, the *Velcro* case has been decided in Canada. The case is important for the same reasons that the *Prévost* case is important (see footnote 128) and because it confirms the test laid down in *Prévost*. The High Court in India recently handed down judgement in *Tata Industries v Deputy Director of International Tax (Mumbai)* 2011 No 38 of 2010. According to Arnold, this case is simply an example of an agent or nominee not being the beneficial owner of the relevant income (Arnold (2011) 65 *BFIT* 555 para 2) and is therefore not discussed here. According to Hansen *et al* (Hansen *et al* (2013) 67 *BFIT* 192 para 1), there are currently ten cases on beneficial ownership before the Danish courts. Two of these have been finalised (*DK ØL 20 Dec 2011 SKM 2012 121* and *DK LK 1 Nov 2010 SKM 2010 729*). These two cases were decided on the basis that a prerequisite for the application of the beneficial ownership requirement is that the relevant payments be made to persons in third-party countries. In these cases, the payments were not made to persons in third-party countries, but rather the payment was made back to a party from whom funds were received, in other words "downstream". These two cases seem to be based on rather unique facts and are therefore not discussed in this dissertation. Since the other eight

In the Netherlands, the *Hoge Raad*¹⁶⁶⁸ in 1994 had to decide whether a stockbroker, who was resident in the United Kingdom, was the beneficial owner of dividends for purposes of the DTT between the Netherlands and the United Kingdom. The stockbroker purchased dividend coupons in Royal Dutch Oil (a Dutch resident company), but not the underlying shares, after the dividends had been declared, but before they had been paid. The stockbroker argued that he qualified for the reduced treaty withholding tax rate, but the Dutch tax authorities disagreed, stating that the stockbroker was not the beneficial owner of the dividends. The *Hoge Raad* held that the stockbroker became the owner of the dividend coupons when he purchased them. The Court assumed that after the purchase, the stockbroker had free disposal of the dividend coupons and, upon cashing them, also had free disposal of the distributions received and that the stockbroker, when cashing the coupons, did not act as agent or nominee. The *Hoge Raad* therefore held that the stockbroker was the beneficial owner of the dividends.

According to Du Toit and Hattingh, it should be noted that the court “focused on the rights in respect of the coupons and payment to conclude that the taxpayer was the beneficial owner of the dividends because he could freely deal with both the coupons and payment”. Furthermore, the court concentrated only on deciding the beneficial ownership question and did not apply any other test (for example, whether or not the sole reason for the scheme was to obtain a tax benefit).¹⁶⁶⁹

The United Kingdom case of *Indofood*¹⁶⁷⁰ is of great importance internationally in the interpretation of the term beneficial owner.¹⁶⁷¹ It will be noticed immediately that the case is a civil matter and not between the tax authorities of a country and a taxpayer. In this case a company incorporated in Indonesia (the “Parent Guarantor”) wanted to raise capital by the issue of loan notes on the international market. The parent guarantor would, however, have been liable for a twenty per cent withholding tax on interest payable to the noteholders. To make use of the lower withholding tax rate (ten per cent) on interest in terms of the DTT between Indonesia and Mauritius, it was decided to incorporate a wholly-owned subsidiary in Mauritius (the “Issuer”), who would issue the loan notes and then on-lend the capital to the parent guarantor. JP Morgan Chase Bank (the “Trustee”), the defendant in the matter, was appointed as the trustee for the noteholders and the paying agent. During the loan period, the Indonesian government cancelled the DTT with Mauritius. In terms of the agreements between the parties, the notes could be redeemed earlier than the agreed date if the parent guarantor became liable to tax in excess of the ten per cent for which the Indonesia-Mauritius DTT provided. However, the notes could be redeemed earlier only if the

Danish cases are still pending before the High Court (although the National Tax Tribunal have ruled on the cases), they will not be discussed in this dissertation.

¹⁶⁶⁸ *Hoge Raad* 6 April 1994 No 28 638 BNB 1994/217. This case is often referred to as the “market maker case”.

¹⁶⁶⁹ Du Toit and Hattingh in *Silke on International Tax* para 9.6.1. See also Du Toit (2010) 64 *BFIT* 500 504.

¹⁶⁷⁰ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] EWCA Civ 158.

¹⁶⁷¹ According to Du Toit, this case is of importance, because it highlights the question whether the test for beneficial ownership is a legal test (that is, based on legal rights) or a practical matter (namely, that amounts are in fact paid in the absence of a legal obligation). Furthermore, the case also involves a back-to-back loan structure, one of the circumstances in which the term beneficial ownership is regarded as particularly problematic. The case is not, however, a case on English law (where a domestic law meaning of beneficial ownership exists) and importance should therefore not for that reason be attached to the case (Du Toit (2010) 64 *BFIT* 500 505).

obligation to pay the higher tax rate could not be avoided by the issuer, taking reasonable measures available to it. After the cancellation of the relevant DTT, the issuer gave notice to the trustee that it would redeem the notes early.¹⁶⁷² However, the trustee alleged that there were reasonable measures available to the issuer to avoid the higher tax rate. This involved the interposition of a company incorporated in the Netherlands (Newco) between the parent guarantor and the issuer. Thus, the issuer would assign its obligations under the loan (from the issuer to the parent guarantor) to Newco and enter into a new loan agreement with Newco. The trustee argued that in terms of the DTT between Indonesia and the Netherlands, the withholding tax on interest payable by the parent guarantor to the Dutch Newco would be reduced to ten per cent.

The court had to decide whether this proposed restructuring would reduce the withholding tax rate to ten per cent or less and, if so, whether it was reasonable for the parent guarantor/issuer to adopt this measure. In deciding the first question, the court had to determine, *inter alia*, whether Newco was the beneficial owner of the interest that would be payable to it by the parent guarantor. This question had to be decided in terms of Indonesian law.

In answering this question, the court quoted from the book by Baker referred to below and the OECD Commentary.¹⁶⁷³ The court held that the fact that neither the issuer nor Newco was or would be a trustee, agent or nominee for the noteholders in relation to the interest receivable from the parent guarantor, was not conclusive. The absence of any entitlement of a noteholder to security over or right to call for the interest receivable from the parent guarantor was not conclusive either. The court confirmed that the term beneficial owner should not be given a meaning derived from the domestic laws of the contracting states, but rather an international fiscal meaning. The court held that beneficial ownership is incompatible with that of the formal owner, who does not have the full privilege to directly benefit from the income.¹⁶⁷⁴ The issuer, or Newco, if interposed, did not have such a privilege, as it was obliged to use the interest received from the parent guarantor to pay the trustee (or the issuer, if Newco was interposed) and could not find income from any other source.¹⁶⁷⁵ The court further stated that the term beneficial owner should not be limited to such a legal and technical approach, but that the substance of the matter should rather be considered. In this regard the court held that in practical and commercial terms, the issuer (and Newco) would be bound to pay to the trustee that which it received from the parent guarantor and that it was impossible for the issuer (or Newco) to derive any benefit from the interest paid to it by the parent guarantor.¹⁶⁷⁶ The court decided that this conclusion was consistent with the purpose and object of the relevant DTTs.¹⁶⁷⁷ Thus the interposition of Newco was not a measure available to the issuer.

¹⁶⁷² At that time both the interest and exchange rates had moved against the parent guarantor to such an extent that it was in the commercial interest of the parent guarantor, but not the noteholders, that the loan notes should be redeemed as soon as possible.

¹⁶⁷³ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] EWCA Civ 158 para 34–38.

¹⁶⁷⁴ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] EWCA Civ 158 para 42.

¹⁶⁷⁵ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] EWCA Civ 158 para 43.

¹⁶⁷⁶ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] EWCA Civ 158 para 44.

¹⁶⁷⁷ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] EWCA Civ 158 para 45.

Du Toit and Hattingh question the significance of this case, given its unique facts and other peculiarities.¹⁶⁷⁸ They also criticise the judgement on the basis that the court, after applying a legal test, continued to apply an economic substance test. Applying the legal test, the court found that the issuer, or Newco, was obliged to pay over the interest received from the parent guarantor to the trustee and according to the authors this is where the court ought to have stopped. The authors suggest that by applying the second leg,¹⁶⁷⁹ the court overstepped the mark, with the risk that ordinary commercial transactions may be caught by this test. They further imply that the blatant treaty shopping structure used in this case may be the key to understanding the decision.¹⁶⁸⁰ Du Toit implies that the case may have been correctly decided based on the application of the legal test and that there was no need for the court to apply a practical matter test.¹⁶⁸¹ Baker adds that that it is not clear whether the legal test or the substance-of-the-matter test would each, by itself, deprive the recipient of beneficial ownership.¹⁶⁸²

Du Toit also criticises the case for its reliance on the Commentary, without providing a legal basis for such reliance. He adds that the court ought to have justified why it referred to Commentary that were inserted into the OECD MTC after the relevant treaty was entered into, particularly if the addition changed the interpretation reflected in the Commentary (which was, arguably, the case here).¹⁶⁸³

In *Her Majesty the Queen v Prévost Car Inc*¹⁶⁸⁴ the Canadian Federal Court of Appeal had to decide whether a Netherlands company, Prévost Holding, was the beneficial owner of a dividend paid to it by its wholly-owned subsidiary, Prévost Car Inc, a company resident in Canada. Prévost Holding paid essentially the same amount to its two shareholders, Volvo (resident in Sweden) and Henleys (resident in the United Kingdom). Prévost Holding had no office, nor employees, in the Netherlands. If Prévost Holding were the beneficial owner of the dividend paid to it by Prévost Car Inc, the tax rate which Prévost Car Inc had to withhold, would be reduced from 25 per cent to five per cent by virtue of the DTT between Canada and the Netherlands.

The court agreed with the court *a quo*'s decision that the term beneficial owner means "the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received".¹⁶⁸⁵ The court also approved the following extract of the court *a quo*'s judgement, saying that it captured the essence of the beneficial ownership concept:

¹⁶⁷⁸ However, in a separate contribution Du Toit holds the view that it is an important case, despite its peculiarities (Du Toit (2010) 64 *BFIT* 500 505).

¹⁶⁷⁹ Namely, that as a practical matter, the Issuer (or Newco) was bound to pay over the amount that it had received from the Parent Guarantor to the trustee.

¹⁶⁸⁰ Du Toit and Hattingh in *Silke on International Tax* para 9.6.2.

¹⁶⁸¹ Du Toit (2010) 64 *BFIT* 500 506.

¹⁶⁸² Baker in *Beneficial Ownership: Recent Trends* 32.

¹⁶⁸³ Du Toit (2010) 64 *BFIT* 500 505.

¹⁶⁸⁴ *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57. Du Toit and Hattingh regard this case as the most significant, as it contains a detailed analysis of the matter, and was decided in a country that utilises both common law and civil law, as well as the English and French languages (Du Toit and Hattingh in *Silke on International Tax* para 9.6.3).

¹⁶⁸⁵ *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57 para 13.

“Where an agency or mandate exists or the property is in the name of a nominee, one looks to find on whose behalf the agent or mandatary is acting or for whom the nominee has lent his or her name. When corporate entities are concerned, one does not pierce the corporate veil unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it, for example, a stockbroker who is the registered owner of the shares it holds for clients.”¹⁶⁸⁶

The court rejected the argument that the beneficial owner is “the person who can, in fact, ultimately benefit from the dividend”, saying that the word “can” opens a myriad of possibilities which would undermine the relative degree of certainty and stability created by DTTs. It continued:

“The Crown, it seems to me, is asking the Court to adopt a pejorative view of holding companies which neither Canadian domestic law, the international community nor the Canadian government through the process of objection, have adopted.”¹⁶⁸⁷

On the facts the court concluded that Prévost Holding was not an agent, mandatary or nominee of Volvo and Henleys. Furthermore, Prévost Holding was not a conduit for Volvo and Henleys and there was no premeditated or automatic dividend flow through to Volvo and Henleys. The shareholders’ agreement between Henleys and Volvo provided that not less than 80 per cent of the profits of Prévost Car Inc and Prévost Holding would be distributed to its shareholders. However, Prévost Holding was not a party to the shareholders’ agreement and neither Henleys nor Volvo could enforce the shareholders’ agreement against Prévost Holding. Prévost Holding’s deed of incorporation did not oblige it to declare a dividend. Prévost Holding was the registered owner of the Prévost Car Inc shares, paid for those shares and owned them. When dividends were received by Prévost Holding in respect of shares it owns, the dividends were the property of Prévost Holding and were available to its creditors, if any, until such time as the management board declared a dividend and the dividend was approved by the shareholders.¹⁶⁸⁸

According to Du Toit and Hattingh, the definition of beneficial ownership given in this case can be regarded as an international fiscal meaning. The test formulated in *Prévost*, which refers to the person who holds *all* the attributes of ownership (possession, use, risk and control), is contrasted to that formulated by Du Toit, which refers to the person whose ownership attributes outweigh those of any other person.¹⁶⁸⁹ The authors suggest that the court’s formulation may be an attempt to reconcile the common law and civil law concepts of ownership, in order to find a commonly accepted meaning of beneficial ownership. They also question why the term ownership (instead of beneficial ownership) is then not used, if *all* the attributes of ownership are required. The authors further point out that the court in *Prévost* applied a legal test, rather than a “practical matter” test, as was done in

¹⁶⁸⁶ *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57 para 13.

¹⁶⁸⁷ *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57 para 15.

¹⁶⁸⁸ *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57 para 16.

¹⁶⁸⁹ Du Toit’s view is referred to in greater detail in ch 8.5.

Indofood.¹⁶⁹⁰ This was despite the fact that the court in *Prévost* accepted the 2003 version of the Commentary, which introduced the “as a practical matter” test and the approach to interpretation which takes a tax avoidance purpose into account. Du Toit doubts whether the court actually applied these two principles in its decision.¹⁶⁹¹ Arnold is of the view that the *Prévost* case makes sense from a policy and practical perspective. He argues that the reduced treaty withholding tax rate of five per cent is lower than the rates agreed in other treaties and that the Canadian government must have realised that it would make Netherlands holding companies an attractive vehicle in which to house Canadian investments. Furthermore, the Canadian treaty negotiators must have known that the Netherlands provided a preferential tax regime for holding companies and that Netherlands holding companies are widely used in international tax planning. Yet the government did not insist on any specific clause in the treaty to prevent treaty shopping. Hence, he argues that the case is in accordance with Canada’s tax treaty policy at the time that the relevant treaty was entered into.¹⁶⁹²

In *Velcro Canada Inc v Her Majesty the Queen*¹⁶⁹³ the Tax Court of Canada applied the test laid down in *Prévost*. The facts were that VCI, a Canadian resident company, manufactured and sold fastening products. VCI was licensed to use the Velcro brands and technology in Canada by VIBV and in return paid a royalty to VIBV. VIBV at all times remained the owner of the Velcro brands and technology. VIBV was initially a resident of the Netherlands and for a number of years VCI deducted the withholding tax on the royalties at a reduced rate in accordance with the DTT between Canada and the Netherlands. A reorganisation of the Velcro group of companies occurred, which saw the residence of VIBV moving to the Netherlands Antilles. There is no DTT between Canada and the Netherlands Antilles and on the day after the reorganisation, VIBV assigned its rights and obligations under the licence agreement with VCI to VHBV, a company resident in the Netherlands. VCI thus paid the royalties to VHBV and continued to deduct the withholding tax at the reduced treaty rate, which at first was ten per cent, but was later reduced to zero per cent. The royalty payment by VCI to VHBV was based on a percentage of the net sale of products. The consideration for the assignment of the rights in terms of the assignment agreements, which VHBV had to pay to VIBV, was 90 per cent of the net sales of products and it had to be paid to VIBV within 30 days of receipt of the royalties from VCI.

The issue before the court was whether VHBV was the beneficial owner of the royalties and therefore entitled to the benefit of the reduced withholding tax rate in terms of the DTT. The court referred to the OECD MTC, on which the relevant DTT was based, and to the Conduit Companies Report.¹⁶⁹⁴ It furthermore quoted extensively from the *Prévost* case, adopting the test for beneficial ownership from that case quoted above. The court then formulated the test to be applied, based on *Prévost*, as follows:

¹⁶⁹⁰ Du Toit and Hattingh in *Silke on International Tax* para 9.6.3. See also Du Toit (2010) 64 *BFIT* 500 507.

¹⁶⁹¹ Du Toit (2010) 64 *BFIT* 500 504.

¹⁶⁹² Arnold in *Beneficial Ownership: Recent Trends* 43.

¹⁶⁹³ *Velcro Canada Inc v Her Majesty the Queen* 2012 TCC 57.

¹⁶⁹⁴ OECD *Double Tax Conventions and the Use of Conduit Companies*.

“[O]ne must determine who has received the payments for his/her own use and enjoyment and assumed the risk and control of the payment he/she received. Here the focus is on the attributes of ownership of the payment/item to be considered.”¹⁶⁹⁵

It held that in terms of the *Prévost* case there were really four elements to the attribution of beneficial ownership, namely (a) possession; (b) use; (c) risk; and (d) control.¹⁶⁹⁶ These words were to be given their ordinary meanings and the court considered the dictionary meaning of each of these words. The court found the word possession to mean “having or holding property in one’s power” or “the exercise of dominion over property”.¹⁶⁹⁷ The word use referred to “the application or employment of something: a long continued possession or employment of a thing for which it is adapted”.¹⁶⁹⁸ By risk was meant “the chance of injury, damage or loss” or “liability for injury, damage or loss that occurs”. Reference here would be to economic loss.¹⁶⁹⁹ Control meant “to exercise power or influence over”.¹⁷⁰⁰ The court determined that the relevant licencing and assignment agreements had to be looked at, to determine who had the possession, use, risk and control of royalties.¹⁷⁰¹

On the facts, the court found that VHBV had three main activities, namely (a) holding shares in subsidiaries; (b) providing lending services to subsidiaries; and (c) managing royalty streams. The reason for the assignment by VIBV to VHBV was to transfer the management of the royalty streams to VHBV.¹⁷⁰² VHBV intermingled the royalties received from VCI with its other funds and used it for a variety of VHBV’s purposes and at VHBV’s own discretion. The funds were not segregated and then paid over to VIBV. Rather, it was transferred to various other accounts, sometimes changed to other currencies and used to fund VHBV’s general activities. VHBV had sole possession and control over the accounts in which the royalties were paid and they earned the interest while the money was in their accounts. There was nothing in the relevant agreements that prevented VHBV from using the money for their own purposes. VHBV assumed the currency risk involved and the royalties were at VHBV’s creditors’ disposal. In short, the court found the possession, use, risk and control of the funds to be with VHBV. Furthermore, the court held that

“there was no predetermined flow of funds. What there is, is a contractual obligation by VHBV to pay to VIBV a certain amount of monies within a specified time frame. These monies are not necessarily identified as specific monies, they may be identified as a percentage of a certain amount received by VHBV from VCI, but there is no automated flow of specific monies because of the discretion of VHBV with respect to the use of these monies.”¹⁷⁰³

The court referred to the Canadian domestic law meaning of the word agent and determined that VHBV was not VIBV’s agent. The court further held that VHBV was not a nominee or conduit for VIBV. VHBV had some discretion as to the use or application of the

¹⁶⁹⁵ *Velcro Canada Inc v Her Majesty the Queen* 2012 TCC 57 para 27.

¹⁶⁹⁶ *Velcro Canada Inc v Her Majesty the Queen* 2012 TCC 57 para 29.

¹⁶⁹⁷ *Velcro Canada Inc v Her Majesty the Queen* 2012 TCC 57 para 35.

¹⁶⁹⁸ *Velcro Canada Inc v Her Majesty the Queen* 2012 TCC 57 para 36.

¹⁶⁹⁹ *Velcro Canada Inc v Her Majesty the Queen* 2012 TCC 57 para 39.

¹⁷⁰⁰ *Velcro Canada Inc v Her Majesty the Queen* 2012 TCC 57 para 41.

¹⁷⁰¹ *Velcro Canada Inc v Her Majesty the Queen* 2012 TCC 57 para 29.

¹⁷⁰² *Velcro Canada Inc v Her Majesty the Queen* 2012 TCC 57 paras 31 and 32.

¹⁷⁰³ *Velcro Canada Inc v Her Majesty the Queen* 2012 TCC 57 para 45.

funds and therefore did not meet the test laid down in the *Prévost* case to be considered a conduit. The court therefore held that VHBV was the beneficial owner of the royalties in question.

Arnold has criticised the *Velcro* case, stating that the reasons for holding that VHBV was the beneficial owner, were not convincing. He argues that the beneficial ownership concept is not very meaningful if all that is required is that the amounts received are intermingled with other funds. He argues that, on the facts, VHBV's powers were very narrow (as the test for a conduit company is formulated in the OECD Commentary) and that it should not have been regarded as the beneficial owner. He also argues that the court's finding that the amount received by VHBV were not the same as that paid by them to VIBV and that VHBV had the discretionary use of ten per cent of the funds received, was based on a misunderstanding of the facts.¹⁷⁰⁴

The Swiss Federal Administrative Tribunal recently pronounced on the meaning of beneficial ownership in a DTT context.¹⁷⁰⁵ The facts in the case were that a bank, resident in Denmark, entered into a number of total return swap transactions in respect of the shares in several Swiss companies. In terms of these transactions, the Danish bank was obliged to pay to the counterparty the increase in value and the dividend paid in respect of the shares. In exchange, the counterparty had to pay interest (at LIBOR¹⁷⁰⁶ plus a margin) to the Danish Bank. In order to hedge their risk, the Danish bank purchased shares in the relevant Swiss companies. Therefore, although the Danish bank was obliged to pay the increase in value and the dividend to the counterparty, it received the same, because it was the owner of the shares in terms of the hedge.

The dividends paid in respect of the shares were subject to a 35 per cent withholding tax and the Danish bank applied for a refund on the basis of the DTT between Switzerland and Denmark. In terms of this DTT dividends paid by a company resident in Switzerland to a person resident in Denmark may be taxed only in Denmark. It will be noticed immediately that the relevant provision, which formed part of a treaty entered into before the 1977 introduction of the beneficial ownership requirement in the OECD MTC, contained no beneficial ownership requirement.

The Federal Administrative Tribunal deemed it unnecessary to decide whether beneficial ownership was an implicit requirement in a provision in which it is not expressly mentioned.¹⁷⁰⁷ It held that if beneficial ownership were a requirement of the relevant DTT, the Danish bank was the beneficial owner. In coming to its decision, the Federal Administrative Tribunal held that "[b]eneficial ownership is a 'substance over form'

¹⁷⁰⁴ Arnold (2012) 66 *BFIT* 323 para 2 and Arnold in *Beneficial Ownership: Recent Trends* 46–47.

¹⁷⁰⁵ *A.A/S v Federal Tax Administration* A-6537/2010. According to Arnold, the case is of importance for situations in which a party is obliged to pay an amount of dividends, interest or royalties to another and a discussion of the case is therefore included in this dissertation (Arnold (2012) 66 *BFIT* 323 para 2).

¹⁷⁰⁶ LIBOR has been described as follows: "The London inter-bank offered rate, or LIBOR, may broadly be defined as the rate at which banks within the London market lend funds to each other for specified maturities. LIBOR is in effect a way of measuring the cost to a bank of raising funds from the market in order to on-lend. It is sometimes used as a benchmark for a safe harbor rate of interest." (Larking *IBFD International Tax Glossary* 250).

¹⁷⁰⁷ *A.A/S v Federal Tax Administration* A-6537/2010 para 3.3.2.

approach based on the underlying economic reality rather than the (civil law) form ...".¹⁷⁰⁸ It further held that beneficial ownership was a prerequisite for treaty entitlement, which concentrates on the scope of the taxpayers' powers to decide on the use of investment income.¹⁷⁰⁹ The court stated that if a person is obliged to pass income on to another, it indicates a limitation on that person's power to decide on the use of the income. Either a contractual obligation or a *de facto* duty to pass the income on may limit the power to decide how the income should be used. The court also highlighted the assumption of risk as a possible indication of beneficial ownership. However, subjective factors, such as the intention of abuse, should be disregarded in determining beneficial ownership. An assessment of beneficial ownership is to be made at the time at which the income is paid.¹⁷¹⁰

On the facts the court found that there was no legal obligation on the Danish bank to pass the dividends on to its counterparty. The court also found that there was no *de facto* obligation to pass on the dividends, based on the facts that (a) the Danish bank was obliged to pay an amount equal to the dividends to the counterparty irrespective of whether it received the dividends; and (b) the Danish bank was free to decide, independently of the swap contracts, whether to buy the shares in question and to receive the dividends.¹⁷¹¹ The court acknowledged that the risk that no dividend would be declared was borne by the counterparty, but decided that this point did not preclude the Danish bank from being the beneficial owner, as the bank hedged the transaction of its own accord.¹⁷¹²

It is submitted that the Swiss Federal Administrative Tribunal applied an economic test, rather than a legal test, in deciding the beneficial ownership question in this case. The court's judgement was based not only on the Danish bank's legal obligations, but also its *de facto* obligations. The court therefore looked at the economic substance rather than the legal form of the transaction.

To conclude regarding the meaning of the term in case law, the court in *Indofood* held that the absence of the relationship of trustee, agent or nominee is not conclusive in determining beneficial ownership. Furthermore, it held that the formal owner, who does not have the full privilege to directly benefit from the income, is not the beneficial owner. The court continued that the term beneficial owner should not be limited to such a legal and technical approach, but rather that the substance of the matter should be considered. In *Prévost* the court held that the beneficial owner is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received. The court furthermore held that the corporate veil of a corporation is not pierced unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it. The court in *Velcro* essentially confirmed the test laid down in *Prévost*. From the decision of the *Hoge Raad* it can be deduced that a person who has free disposal of the income in question and who is not an agent or nominee, is the beneficial owner. The Swiss

¹⁷⁰⁸ *A.A/S v Federal Tax Administration* A-6537/2010 para 3.4.1. The court used the English expression "substance over form" in the original text.

¹⁷⁰⁹ *A.A/S v Federal Tax Administration* A-6537/2010 para 3.4.1.

¹⁷¹⁰ *A.A/S v Federal Tax Administration* A-6537/2010 para 3.4.2.

¹⁷¹¹ *A.A/S v Federal Tax Administration* A-6537/2010 para 6.2.1.

¹⁷¹² *A.A/S v Federal Tax Administration* A-6537/2010 para 6.2.2.

Federal Administrative Tribunal applied a practical, rather than a legal, test to determine beneficial ownership. It found that if a person's power to decide on the use of the relevant income was limited, either through a legal or *de facto* obligation, that person could not be regarded as the beneficial owner.

It is submitted that one can deduce the following from the case law:

- (a) The absence of the relationship of trustee, agent or nominee is not conclusive to determine beneficial ownership.
- (b) The attributes of ownership, namely possession, use and enjoyment, risk and control, will be investigated and the person who holds all these attributes will be considered the beneficial owner of the income.
- (c) An entity will not be regarded as a beneficial owner if it has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it.
- (d) In applying these tests, some courts apply a legal test only, in other words, these courts only consider legally binding rights and obligations. Other courts apply a practical test (also referred to as an "economic test" or a "substance over form test") only, or in addition to the legal test, to determine whether a person may dispose of income.
- (e) The motive to avoid tax does not determine beneficial ownership.

8.5 Views of academic authors on the meaning of beneficial ownership

As stated above, Oliver argues that the domestic law meaning of the term should not apply, but that a particular treaty meaning should rather be used. He then suggests that there are three meanings to beneficial ownership that should be considered:¹⁷¹³

- (a) The domestic law meaning in the common law states, imported into the OECD MTC as a universal meaning. It is argued that this meaning is the following: "The beneficial owner is the person whose ownership attributes outweigh those of any other person."¹⁷¹⁴

¹⁷¹³ Oliver (2001) 1 *BTR* 27 53 and further. It should be noted that this article was based on a previous version of the Commentary.

¹⁷¹⁴ Oliver (2001) 1 *BTR* 27 56. This meaning was expressed by Du Toit in his doctoral dissertation: "The term was taken from the common law states and incorporated into the OECD Model. The term is not known in the domestic law of states other than the common law states. It can properly be classified as international tax language. It is not defined in the OECD Model. No OECD member state has expressed either a reservation or an observation as to its meaning in the OECD Model. The meaning of beneficial owner at the source that it was taken from, that is, the common law states, should therefore be taken as the starting point for the investigation of its international tax meaning in those bilateral tax treaties which have adopted the wording of the OECD Model. This meaning should then be modified, if necessary, in the context of the treaty and in the light of its object and purpose. This whole process of interpretation should be in accordance with the steps as prescribed by the Vienna Convention. By applying the reasoning and steps as described above, the following

- (b) A definition which excludes agents and nominees.
- (c) The person to whom the income is attributable for tax purposes, under the law of the residence state or the source state.

Du Toit rejects meaning (b) above, because the words “such as” were used in front of “agent” and “nominee” in the 1977 version of the Commentary. The words “such as” indicated that that “agent” and “nominee” are mere examples of intermediaries that are excluded as beneficial owners.¹⁷¹⁵ Commenting on the wording of the Conduit Companies Report (which was subsequently incorporated into the Commentary in 2003), Du Toit states that the passage confirms that beneficial ownership goes further than merely excluding agents and nominees.¹⁷¹⁶

Baker, agreeing that the domestic law meaning of the term should not be applied, but rather the international fiscal meaning, suggests, based on the OECD’s latest Commentary, that the term beneficial ownership excludes from the benefit of articles 10, 11 and 12:

“(a) mere nominees or agents, who are not treated as owners of the income in their country of residence;

(b) any other conduit who, though the formal owner of the income, has very narrow powers over the income which render the conduit a mere fiduciary or administrator of the income on behalf of the beneficial owner.”¹⁷¹⁷

Vogel describes the beneficial ownership test as follows:

“Treaty benefits should not be granted with a view to a formal title to dividend, interest or royalties, but to the ‘real’ title. In other words, the old dispute of ‘form versus substance’ should be decided in favour of ‘substance’.... The ‘substance’ of the right to receive certain yields has a dual aspect. The first is the right to decide whether or not a yield should be realized – i.e. whether the capital or other assets should be used or made available for use; the second is the right to dispose of the yield. Ownership is merely formal, if the owner is fettered in regard to both aspects either in law or in fact. On the other hand, recourse to the treaty is justified – i.e. is not improper – if he who is entitled under private law is free to wield at least one of the powers referred to. Hence the ‘beneficial owner’ is he who is free to decide (1) whether or not the capital or other assets should be used or made available for use by others or (2) on how the yields therefrom should be used or (3) both.”¹⁷¹⁸

answer is reached: The beneficial owner is the person whose ownership attributes outweigh those of any other person.” (Du Toit *Beneficial Ownership of Royalties in Bilateral Tax Treaties* 20–21).

¹⁷¹⁵ Du Toit *Beneficial Ownership of Royalties in Bilateral Tax Treaties* 216.

¹⁷¹⁶ Du Toit *Beneficial Ownership of Royalties in Bilateral Tax Treaties* 218.

¹⁷¹⁷ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* para 10B–14.

¹⁷¹⁸ Vogel *et al Klaus Vogel on Double Taxation Conventions* 562.

Vogel's view, which focuses on the aspect of control, is criticised by Du Toit. He asks who will be regarded as beneficial owner if the powers (1) and (2) described by Vogel are in different persons.¹⁷¹⁹

According to Danon, a beneficial owner is

"the person who legally, economically or factually has the power to control the attribution of the income. This definition differs essentially from the common law meaning of 'beneficial ownership' in that it does not require that the recipient of the income be able to enjoy the economic benefits of the item received. Moreover, it is submitted that this meaning remains perfectly in line with the OECD Commentary and Conduit Report. Indeed it excludes agents, nominees and conduit entities with narrow powers on the ground that these persons are not in a position to control the attribution of the income (being legally, economically or factually bound by the instructions of their principal, shareholders, participants, creditors, etc.)."¹⁷²⁰

According to Panayi, the beneficial ownership test laid down in *Indofood* is too narrow. Furthermore, she argues that the focus of the beneficial ownership test should not be on where the money ends up, but whether the person who receives the money actually conducted an activity which generated the money. Thus, she argues that the test for beneficial ownership, based on the *Indofood* decision, should be whether a person is legally and economically entitled to the income through having earned or generated it in some real way. She views the risk factor as important to determine beneficial ownership. That is, does the ultimate recipient run the risk of ever not receiving the income?¹⁷²¹

Vann suggests that beneficial ownership should entail the following:

"In terms of principle, it is suggested that the OECD distinguish two cases in relation to beneficial ownership. First, if the country of residence of the person to whom the income is paid does not attribute it to that person, that person will not be the beneficial owner of the income. Secondly, if the country of residence does attribute the income to that person, that person will not be treated as the beneficial owner of the income in only a very limited number of situations. The preferred approach would be to return to the simple 'agent or nominee' test of the 1977 Commentary.

If it is considered necessary in the light of subsequent OECD developments to go further to include certain conduit situations, the crucial point should be that a person is not the beneficial owner of income to which the person is legally entitled and to whom the income is attributed for tax purposes if the person has no control over its application due to an immediate and legally enforceable obligation to pass the income on to another person. Only obligations attaching to specific items of income should prevent the person subject to the obligation from being the beneficial owner of the income received; obligations affecting a basket of various items of income should not have this effect if the person subject to the obligation is able to decide which incoming

¹⁷¹⁹ Du Toit *Beneficial Ownership of Royalties in Bilateral Tax Treaties* 149.

¹⁷²⁰ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 340.

¹⁷²¹ Panayi *Double Taxation, Tax treaties, Treaty-shopping and the European Community* 49.

item of income will be used to satisfy which obligation. Further, it should be made clear that if a person is entitled to retain the income for use as the person decides, that person is the beneficial owner even though at some future time that income is likely to be paid over to a third person (which will be the case for virtually all income received by a legal entity). As was noted in the conduit company report from which this kind of extension originates, it will have little impact on treaty shopping and the question arises whether the uncertainty created by such an extension is worth the small impact on treaty shopping.¹⁷²²

Reimer suggests that the beneficial owner should be identified by applying two criteria, each of which contains certain sub-criteria. The first criterion is the examination of the payment and the *causa* for the payment. As sub-criteria, Reimer suggests that (a) the period before the payment be scrutinised (for example, does the later recipient of the payment have a claim even before the payment is made, or is the payment due to another, who then requests a bypass from the payor); (b) the person who bears the risk of non-payment and currency be identified; and (c) the period after the payment be scrutinised (for example, can the person retain the payment and use it for discretionary purposes, or is there an obligation to forward the payment). The second criterion is the income-generating object. According to Reimer, if the recipient has a special relationship to the asset, it is a strong indicator that that person is the beneficial owner. As sub-criteria, he proposes (a) the acknowledgement of a split between the asset and the yields associated with the asset where such a split may economically be justified (for example, if a *quid pro quo* is given); (b) that in the absence of such a split, the economic owner of the asset be identified as an indication of the beneficial owner, (he proposes that the economic owner be identified by applying the functional analysis in terms of article 7(2) of the OECD MTC); (c) the activities associated with the asset be examined (for example the human activities involved in the creation of an asset); and (d) if a person shares the risks associated with an asset, it is an indicator that that person is the beneficial owner. He adds that no single criterion may be absolute to determine beneficial ownership, but rather, it is the interplay between the criteria which provides an answer in determining who the beneficial owner is.¹⁷²³

8.6 Can a trust (or a trustee) be a beneficial owner?

8.6.1 The views of academic authors

According to Baker it is clear that a trustee can be regarded as a beneficial owner as long as he does not act as a mere nominee or agent or have such narrow powers as to be rendered a mere fiduciary.¹⁷²⁴

Vogel asserts that if a trustee has the power to decide whether or not the capital or other assets should be used or made available for use by others, or how the yields therefrom should be used, or both, the trustee will be regarded as the beneficial owner.¹⁷²⁵

¹⁷²² Vann (2012) 66 *Sydney Law School: Legal Studies Research Paper* 35–36.

¹⁷²³ Reimer in *Beneficial Ownership: Recent Trends* 257–263.

¹⁷²⁴ Baker *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* 10B–14.

¹⁷²⁵ Vogel et al *Klaus Vogel on Double Taxation Conventions* 562.

A contrary view is held by Du Toit. He contends that, because a trustee does not exercise his or her powers of control over the income for his or her own benefit (but rather for the benefit of the beneficiary), the trustee cannot be the beneficial owner.¹⁷²⁶ He also views a trustee as an example of an intermediary, akin to an agent and a nominee, with the consequence that a trustee cannot be the beneficial owner of income.¹⁷²⁷

Danon takes issue with Du Toit's view that a trustee is akin to an agent and a nominee. He argues that a trustee is independent of beneficiaries and settlors and sometimes has a very broad discretion in the management of trust assets. In contrast, agents and nominees are described as "inanimate tools in the hands of their principal". Accordingly, there is a difference between a trustee, on the one hand, and an agent and a nominee, on the other.¹⁷²⁸ Since a trustee is not an agent or a nominee, there is *prima facie* nothing to prevent a trustee from being a beneficial owner for DTT purposes.¹⁷²⁹ Danon further argues that the purpose of the beneficial ownership requirement is to combat treaty shopping. Hence, he argues, the ownership attributes which allow this goal to be achieved should be identified. In his view, the power to control the attribution of income is the most important ownership attribute, since no one would enter into a treaty shopping arrangement without the power to control the interposed vehicle to ensure the transfer of the income to him or her. He therefore argues that the right to enjoy the economic benefits of the income is not decisive. Thus, the fact that a recipient does not use his or her power of control for his or her own benefit is not critical.¹⁷³⁰ In applying the control test to trusts, Danon distinguishes between different types of trusts.¹⁷³¹ Where income is attributed to the trust, but the trustees have no discretion whether or to whom the income should be distributed, the trustees will not be regarded as the beneficial owners, as they have no control over the attribution to the beneficiary. A typical example is a vesting trust in which the trustees are obliged to distribute income to a beneficiary and the beneficiary may enforce such a right.¹⁷³² Where income is attributed to a trust, but the trustees have a discretion to accumulate the income and in fact do so, the trust will be regarded as the beneficial owner of the income, since the beneficiaries cannot legally compel the trustees to distribute the income to them.

Prebble notes that a trustee is not "an intermediary such as an agent or nominee", as is required by the wording used by the 1977 Commentary. Agents and nominees have no relevant status independent of their principals, whereas trustees have functions which are

¹⁷²⁶ Du Toit *Beneficial Ownership of Royalties in Bilateral Tax Treaties* 149.

¹⁷²⁷ Du Toit *Beneficial Ownership of Royalties in Bilateral Tax Treaties* 216.

¹⁷²⁸ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 334.

¹⁷²⁹ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 333.

¹⁷³⁰ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 335–340.

¹⁷³¹ Danon *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* 340–343. The types of trusts discussed by Danon have been adapted for purposes of this dissertation. Danon discusses specific types of Canadian trusts. This dissertation seeks to apply the principles discussed in Danon's work to other trusts as well, in an attempt to make the discussion more general.

¹⁷³² According to Danon, if a trustee is obliged to distribute income during a particular year, but may choose the beneficiary from a given class, the trustee will still not be regarded as the beneficial owner.

independent of their beneficiaries and settlors.¹⁷³³ On this point Prebble and Danon are in agreement. Prebble avers that by 1977, the question of whether a trustee could be regarded as a beneficial owner were well known and that the omission of the term trustee from the formulation which included agent and nominee, was not accidental.¹⁷³⁴ He further contends that the statement in the 2003 version of the Commentary, that the term beneficial owner “is not used in a narrow technical sense”, indicates that at least some trustees may be beneficial owners, since the only “narrow technical sense” comes from the common law of trusts.¹⁷³⁵ He reinforces this point by arguing that by 2003, Du Toit’s view that the term beneficial ownership was taken from the common law countries and used in international fiscal language, had gained support. The inclusion of the point that the term was not used in its narrow technical sense can only refer to its sense in trust law and is therefore telling.¹⁷³⁶ Prebble further argues that some trustees are taxed on foreign sourced income and should therefore qualify as beneficial owners and obtain relief. The argument asserts that if these trustees qualify as beneficial owners, all trustees should qualify as beneficial owners.¹⁷³⁷ He furthermore maintains that the French¹⁷³⁸ version of the term, *bénéficiaire effectif*, includes a trustee and that the French and English versions of the term should be afforded the same meaning.¹⁷³⁹

Prebble furthermore suggests that the *Indofood* case, laying down a “substance over form” test, where mere conduits are ignored, indicated that a trustee may not be regarded as the beneficial owner. However, he counters this argument by distinguishing the *Indofood* case from a trust situation, stating that a trustee is not a mere conduit.¹⁷⁴⁰

Avery Jones *et al* interpret the passage contained in the Conduit Companies Report,¹⁷⁴¹ referring to other conduits with very narrow powers (which render them a mere fiduciary or administrator acting on account of interested parties) to indicate that the beneficiary of a vesting trust will be the beneficial owner of the income. They state that this passage does not solve the question in relation to accumulation trusts.¹⁷⁴² Further in their report, Avery Jones *et al* indicate that at least some countries, notably Canada, will regard a trustee of accumulation trusts as the beneficial owner under certain circumstances. Their view is that in the United Kingdom, the trustee will not be regarded as the beneficial owner, based on domestic law.¹⁷⁴³

Vann approaches the issue from a historical perspective. He concludes that prior to the introduction of the term in the OECD MTC, common law countries agreed that the trustees of accumulation trusts were beneficial owners if they were taxed on the income, thereby

¹⁷³³ Prebble (2004) 2 *eJournal of Tax Research* 201.

¹⁷³⁴ Prebble (2004) 2 *eJournal of Tax Research* 203.

¹⁷³⁵ Prebble (2004) 2 *eJournal of Tax Research* 201. Essentially the same argument is made in Prebble (2008) VIII *Trusts and Tax Treaties* 75 78.

¹⁷³⁶ Prebble (2004) 2 *eJournal of Tax Research* 204.

¹⁷³⁷ Prebble (2004) 2 *eJournal of Tax Research* 205–206 and Prebble (2008) VIII *Trusts and Tax Treaties* 75 78.

¹⁷³⁸ English and French are the two official languages of the OECD MTC and both carry equal authority.

¹⁷³⁹ Prebble (2004) 2 *eJournal of Tax Research* 206 and Prebble (2008) VIII *Trusts and Tax Treaties* 75 79.

¹⁷⁴⁰ Prebble (2008) VIII *Trusts and Tax Treaties* 75 79–80.

¹⁷⁴¹ Which was later incorporated in the Commentary.

¹⁷⁴² Avery Jones (1989) 3 *BTR* 65 70.

¹⁷⁴³ Eg Avery Jones (1989) 3 *BTR* 65 76.

rejecting a trust law meaning of the term.¹⁷⁴⁴ He analyses the report of the Working Party¹⁷⁴⁵ responsible for the introduction of the term into the OECD and concludes that:

“they did not think that payment to a resident who was merely an agent was a problem, thus implying a concept of real ownership throughout the Model (though, as they had noted in their earlier report, there were administrative issues in such cases). They saw the problem as being related to trustees and even then only in some states. While the trust situation has now been introduced, the discussion seems to be dealing with cases where the beneficiary is immediately entitled to the income, not with accumulation trusts.”¹⁷⁴⁶

Schwarz suggests that where the term beneficial owner is inserted in treaties, the intention is to distinguish between beneficial and legal owners. He also implies that in treaties containing the term, a trustee will not be able to claim treaty benefits.¹⁷⁴⁷

8.6.2 The case law

In *Indofood* the court applied, in addition to the legal test, also a practical (or substance over form) test. The court held that, practically speaking, the issuer (and Newco) would be obliged to pay on to the trustee the amount received from the parent guarantor and that it was impossible for the issuer (or Newco) to derive any benefit from the interest received from the parent guarantor. Applying this test to trusts, it would be hard to argue that a trust (or trustee) derives any benefit from payment that it receives, because these payments are, by definition, for the benefit of its beneficiaries.¹⁷⁴⁸

In the Tax Court of Canada’s judgement in the *Prévost* case, the position of trusts was used as an example of a person who holds property for the benefit of another. The court stated that:

“[t]he trustee is the legal owner but does not personally enjoy the attributes of ownership, possession, use, risk and control. The trustee is holding the property for someone else and that, ultimately, it is that someone else who has the use, risk and control of the property.”¹⁷⁴⁹

The court then formulated the test for beneficial ownership, which was eventually approved by the Federal Court of Appeal,¹⁷⁵⁰ as follows:

“In my view the ‘beneficial owner’ of dividends is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received. The person who is beneficial owner of the dividend is the person who enjoys and assumes all the attributes of ownership. In short the

¹⁷⁴⁴ Vann (2012) 66 *Sydney Law School: Legal Studies Research Paper* 13.

¹⁷⁴⁵ Working Party 27. See Vann (2012) 66 *Sydney Law School: Legal Studies Research Paper* 14.

¹⁷⁴⁶ Vann (2012) 66 *Sydney Law School: Legal Studies Research Paper* 17.

¹⁷⁴⁷ Schwarz *Schwarz on Tax Treaties* 310.

¹⁷⁴⁸ However, see Prebble (2008) VIII *Trusts and Tax Treaties* 75 79–80 discussed in ch 8.6.1.

¹⁷⁴⁹ *Prévost Car Inc v Her Majesty the Queen* 2008 TCC 231 para 98.

¹⁷⁵⁰ *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57 para 13 and para 14.

dividend is for the owner's own benefit and this person is not accountable to anyone for how he or she deals with the dividend income."¹⁷⁵¹

From these passages in the *Prévost* case, it can be inferred that a trustee cannot be the beneficial owner of income for treaty purposes, as the trustee does not, generally, hold the property for his or her own benefit and, consequently, does not personally enjoy all the attributes of ownership. This inference accords with the view held by Du Toit.¹⁷⁵²

8.6.3 OECD revised proposals: October 2012

If the proposal is included in the Commentary, it will, for the first time, address the issue of trusts in relation to beneficial ownership. The Commentary¹⁷⁵³ will then stipulate that the term was never intended to refer to any technical meaning that it could have had under the domestic law of a specific country and that it is not used in the narrow technical sense that the trust law of many common law countries uses. A footnote¹⁷⁵⁴ expands on this statement by giving an example: Where the trustees of a discretionary trust do not distribute dividends earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer), could constitute the beneficial owners of such income for the purposes of article 10, even if they are not the beneficial owners under the relevant trust law.¹⁷⁵⁵

This part of the Commentary is therefore explicit that the term does not have the same meaning in DTTs as it has under the trust law of common law states. It also gives an example of where a trust (or trustee) can be regarded as the beneficial owner. The fact that a discretionary trust that accumulates income in a given period is used as an example, means that there may be other circumstances under which a trust (or the trustee) may also be regarded as beneficial owner. It is submitted that the more general paragraphs regarding the meaning of beneficial ownership should therefore be applied to determine whether a specific trust (or the trustee) could be regarded as a beneficial owner. This issue will be further explored below.

The proposed Commentary will retain the statements regarding agents and nominees not qualifying as beneficial owners, as well as the statements regarding conduits who, although formal owners, have such narrow powers that it render them mere fiduciaries or administrators, acting on account of the interested parties.¹⁷⁵⁶ As under the current Commentary (that is, the 2003 Commentary), it is important to note that in none of the states discussed in this dissertation will a trust (or trustee) be regarded as an agent or nominee of the beneficiaries or the settlor.¹⁷⁵⁷ Thus, it remains to be considered whether a trust can be regarded as a conduit acting as a fiduciary or administrator. As under the

¹⁷⁵¹ *Prévost Car Inc v Her Majesty the Queen* 2008 TCC 231 para 100.

¹⁷⁵² Du Toit *Beneficial Ownership of Royalties in Bilateral Tax Treaties* 149. See ch 8.6.1.

¹⁷⁵³ The proposed Commentary on art 10 is used as an example again. Similar Commentary is proposed for arts 11 and 12.

¹⁷⁵⁴ Danon criticises the proposed Commentary because the position of trusts is discussed in a footnote and not in the main text. In fact, he proposes that a separate section on the application of the OECD MTC to trusts be incorporated in the Commentary to article 1 (Danon (2011) 65 *BFIT* 437 440).

¹⁷⁵⁵ Proposed Commentary on the OECD MTC art 10 para 12.1.

¹⁷⁵⁶ Proposed Commentary on the OECD MTC art 10 para 12.2 and 12.3.

¹⁷⁵⁷ See ch 2.7.

current Commentary, the proposed Commentary refers to the Conduit Companies Report and uses the words “conduit company”. Consequently, the question arises whether a trust (or the trustee), which is not a company, can be regarded as a conduit. It is submitted that the answer must be in the affirmative. Both the article and the Commentary (current and proposed) refer to a “resident of a Contracting state”. It was argued elsewhere that a trust (or the trustee) can often be regarded as “residents” for purposes of the OECD MTC.¹⁷⁵⁸ If a trust (or trustee) is regarded as a resident, it would be able to act as a conduit. From a policy perspective, it would not make sense to exclude a trust (or trustee) as it would be easy to circumvent the beneficial owner requirement by using a trust rather than a company, especially now that the proposed Commentary explicitly states that a trust (or the trustee) can be a beneficial owner. Therefore, it is submitted that if the trustees of a trust have very limited powers, it should be investigated whether they could be regarded as mere conduits.¹⁷⁵⁹

The proposed Commentary¹⁷⁶⁰ further states that an agent, a nominee and a conduit company acting as a fiduciary or administrator, are *examples* of persons who are not beneficial owners. The reason it provides is that in these cases the recipient’s right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person. Although the Commentary acknowledges that the obligation will usually be found in legal documents, it may also be deduced from facts and circumstances. It adds, however, that the obligation must be related to the payment received and gives a number of examples of payments that would be considered unrelated to the payment received.

It is submitted that the proposed Commentary now makes it clear that only a contractual or legal obligation to pass on the relevant payment may be considered. Even though these may not be expressed in a legal document, the facts and circumstances may only be used to show that a contractual or legal obligation exists. The substance over form or economic test proposed in *Indofood* and accepted by certain authors, is therefore not supported in the proposed Commentary.

In relation to trusts, the proposed Commentary would therefore mean that if the trust (or trustee) has the obligation to pass the income on to a beneficiary, the trust(ee) will not be regarded as the beneficial owner of the income, since the trust’s (or trustee’s) right to use and enjoy the income is constrained by the obligation. Therefore, in the case of a vesting trust, the trustees are obliged to distribute the income to the beneficiaries and the beneficiaries have enforceable rights against the trustees to do so.¹⁷⁶¹ Hence a vesting trust (or its trustee) cannot, in terms of this proposed Commentary, be regarded as the beneficial owner of the income. If the trustee of a discretionary trust decides to distribute income to a specific beneficiary during the relevant tax year, the trustee will be obliged to pass the income to the beneficiary, the beneficiary obtaining an enforceable right against the

¹⁷⁵⁸ See ch 5.

¹⁷⁵⁹ This view is supported by Baker, who suggests that under the current Commentary, a trustee can be a beneficial owner as long as he does not, inter alia, have such narrow powers as to be rendered a mere fiduciary (see ch 8.1.6).

¹⁷⁶⁰ Proposed Commentary on the OECD MTC art 10 para 12.4.

¹⁷⁶¹ See ch 2.2.4 (South Africa), 2.3.3.1 (England), 2.3.3.2 (Scotland), 2.4.4.1 (the rest of Canada) and 2.4.4.2 (Québec) for a discussion of the rights of beneficiaries in a vesting (or fixed) trust.

trustee.¹⁷⁶² Hence, the trust will, after the exercise by the trustee of his or her discretion, not be regarded as the beneficial owner of the income.¹⁷⁶³ If a trust accumulates the income, the beneficiaries in a discretionary trust have no rights to force the trustee to pay the income to them and, therefore, the trust will be regarded as the beneficial owner of the income. If, after a number of years, the trustee decides to vest the income in a beneficiary, it is submitted that the trust will not cease to be the beneficial owner of the income. Two reasons may be advanced for this proposition: First, the income will not retain its character and will become part of the trust's capital.¹⁷⁶⁴ Second, there "seems to be a general expectation that a treaty can be applied as the income is paid out of the source state".¹⁷⁶⁵

If a letter of wishes is not legally binding, but it is invariably followed by the trustee, resulting in the trustee distributing the income in accordance with the letter of wishes, one may ask whether the letter of wishes can constitute the facts and circumstances that indicate that the trustee is obliged to distribute the income.

An example of where a court may consider a trust to be a mere fiduciary or administrator with very narrow powers, because it is obliged to pass the income on to a beneficiary, may be found in two South African cases on the taxation of trusts. In *Armstrong*¹⁷⁶⁶ the taxpayer (the beneficiary) was entitled to receive 2 000 pounds per annum from the trust and the balance of the trust income was to be distributed to the taxpayer's daughters. During the relevant year of assessment, the trust received income in the form of dividends, interest and rent. The taxpayer disclosed her income of 2 000 pounds as consisting partly of dividends and partly of interest and rent, but the revenue authorities denied her the exemption in respect of dividends. The court first referred to a simple case where the trustee derived only dividend income and only one beneficiary was entitled to all of the income from the trust. The court ruled that in such a case the trustee was a mere "conduit pipe" and that the beneficiary derived the income from the company. The court also referred to the beneficiary

¹⁷⁶² See ch 2.2.4 (South Africa), 2.3.3.1 (England), 2.3.3.2 (Scotland), 2.4.4.1 (the rest of Canada) and 2.4.4.2 (Québec) for a discussion of the rights of beneficiaries in a discretionary trust.

¹⁷⁶³ No practical problem will arise if the trustee exercises his or her discretion to distribute income to a beneficiary immediately or very soon after the trustee receives the income. However, a practical problem may arise if the trustee receives the income from the source state and decides to distribute the income to the beneficiary within the same tax year, but only after some time has lapsed. Eg, the trustee decides to distribute the income to the beneficiary six months after it has received the income from the source state. The beneficiary will have an enforceable right against the trustee for the payment of the amount and, eg in South Africa, the income will be taxed in the beneficiary's hands and retain its nature. In theory, the trust is therefore not the beneficial owner in terms of the Commentary. However, at the time that the source state has to determine whether the trust is the beneficial owner (that is, when the payment is made), it is unknown that the trustee will exercise his or her discretion in favour of the beneficiary. Under these circumstances, the source state will probably treat the trust as the beneficial owner, similar to the situation in which the trust accumulates the income. The practical difficulty may be less acute in states which require the taxpayer to reclaim the withholding tax afterwards. The practical problem is also eliminated if the preferred view, which is set out in ch 8.6.4, is followed.

¹⁷⁶⁴ Authority for this proposition is as follows: in South Africa the *obiter* statement in *Rosen (Secretary for Inland Revenue v Rosen)* 1971 1 SA 172 (A) 190–191; in the United Kingdom, trustees may accumulate income and pay it out to beneficiaries as capital, provided that they have power to do so (*Kessler Taxation of Non-Residents and Foreign Domiciliaries* 1072); in Canada income that is not paid to a beneficiary is taxed in the trust and when it is subsequently paid to a beneficiary, it forms part of the capital of the trust (*Hogg et al Principles of Canadian Income Tax Law* 550).

¹⁷⁶⁵ Wheeler (2011) 3 *World Tax Journal* 247 345.

¹⁷⁶⁶ *Armstrong v Commissioner for Inland Revenue* 1938 AD 343; 10 SATC 1.

as “beneficially entitled” to the income.¹⁷⁶⁷ The reasoning adopted in the simple case also applied to the more complex facts of the case and therefore the taxpayer was entitled to the exemption in respect of dividends.

In *Rosen*,¹⁷⁶⁸ the court, commenting on the *Armstrong* case, stated:

“The principle rests upon sound and robust common sense; for, by treating the intervening trustee as *a mere administrative conduit-pipe*, it has regard to the substance rather than the form of the distribution and receipt of the dividends.”¹⁷⁶⁹ (own emphasis)

Later in the judgement, the court made its famous *obiter* statement, which reads as follows:

“It suffices to say that the trust deed may itself entitle or oblige the trustee to administer the dividends in such a way that he is not a mere conduit-pipe for passing them on to the beneficiary, that in his hands their source as dividends can no longer be identified or they otherwise lose their character and identity as dividends, and that the beneficiary is thus entitled to receive mere trust income in contradistinction to the benefit of the dividend rights in terms of the above crucial phrase. Thus, a trust deed may endow the trustee with a discretion to pass on dividends to the beneficiary or to retain and accumulate them. If he decides on the latter, I think (but express no firm view) that the dividends might then lose their identity and character as dividends, so that, if they are subsequently paid out to the beneficiary, they might possibly no longer be dividends in his hands, for the conduit-pipe had turned itself off at the relevant time. But if he decides on the former, i.e. to pass the dividends on to the beneficiary, the condition suspending the beneficiary’s entitlement thereto is fulfilled, and they would constitute dividends in his hands in the same way as if he had been originally entitled to them unconditionally under the trust deed, i.e. as if the conduit pipe had always been open.”¹⁷⁷⁰

It may be inferred from these cases that in South Africa a trust is regarded as a “mere administrative conduit-pipe” (to use the phrase from *Rosen* in the previous quote) in cases where a beneficiary has a vested right to income in a specific year of assessment.¹⁷⁷¹ In other words, in the case of a beneficiary with a vested right to income, the trust may well, in terms of South African law, be regarded as a mere fiduciary or administrator acting on account of the beneficiary. Consequently, such a trust will not be regarded as the beneficial owner of

¹⁷⁶⁷ *Armstrong v Commissioner for Inland Revenue* 1938 AD 343; 10 SATC 1 349.

¹⁷⁶⁸ *Secretary for Inland Revenue v Rosen* 1971 1 SA 172 (A).

¹⁷⁶⁹ *Secretary for Inland Revenue v Rosen* 1971 1 SA 172 (A) 188.

¹⁷⁷⁰ *Secretary for Inland Revenue v Rosen* 1971 1 SA 172 (A) 190–191.

¹⁷⁷¹ Regarding the meaning of “vested right”, see ch 2.2.4. A beneficiary may have the vested right to income in a specific year because the beneficiary always had such a right, which would typically be specified in the trust deed. A beneficiary may also have the vested right to income in a specific year because the trustees exercised their discretion in favour of the beneficiary during that year. If trustees exercise their discretion in favour of a beneficiary, its effect would depend on the terms of the trust deed and the decision of the trustees. The trustees could decide to distribute an amount to a beneficiary only in that particular year of assessment, or they could decide that from then on the particular income stream would always be distributed to the beneficiary. In the latter case, the beneficiary will, from that year onwards, have a vested right to the income stream.

the income in terms of the proposed (and current) Commentary. If, however, the conduit-pipe turns itself off, that is, the trustees decide to accumulate the income during the year of assessment, the trust will not be a mere fiduciary or administrator acting on account of the beneficiary and will, consequently, be regarded as the beneficial owner.

If the proposal is included in the Commentary, it would mean that the Commentary on the relevant articles would change substantially. Will these amendments to the Commentary influence a court's interpretation of a treaty entered into before the adoption of the proposed amendments? At least in one place, the Commentary states that the term was never intended to have the meaning that it has in the trust law of the common law states. Will this statement carry more authority in interpreting earlier treaties, since it purports to give the "initial" meaning of the term? Surely the role and status of the Commentary and a court's ability to rely on Commentary added to the OECD MTC at a later date than the date that a specific treaty was entered into will become extremely important matters for a court to consider.¹⁷⁷² To the extent that the Commentary conflicts with existing case law, which a court may refer to, the weight attached to each will have to be determined.

8.6.4 Conclusion regarding the question whether a trust can be a beneficial owner

A trust (or the trustee) is not an agent or nominee for the beneficiaries and cannot, on this basis, be disqualified as a beneficial owner.¹⁷⁷³ According to case law and the OECD Commentary, the absence of an agent or nominee relationship does not, however, in itself mean that the beneficial ownership requirement is met. The further meaning of the term beneficial owner (that is, other than excluding agents and nominees) should therefore be determined to decide whether a trust(ee) could qualify.

The current (that is, 2003) Commentary reads that the term is not used in a narrow technical sense¹⁷⁷⁴ and according to Prebble this means that the term is not used in the sense used by the trust law of common law countries.¹⁷⁷⁵ The proposed Commentary makes this point clear by stating that the term never intended to refer to any technical meaning that it could have had under the domestic law of a specific country and that it is not used in the narrow technical sense that the trust law of many common law countries use. It also includes the example of a trust being a beneficial owner. The current and proposed Commentary therefore stand in sharp contrast to the view held by Du Toit and expressed in *Prévost*, namely that the trustee, who does not hold the trust property for his or her own benefit and, therefore, does not personally enjoy all the attributes of ownership, cannot be the beneficial owner.

It is submitted that a court's view regarding the role of the Commentary will influence its decision. If it adopts an ambulatory approach and is of the view that the proposed Commentary is merely to clarify the meaning that the term previously had, and it attaches more value to the Commentary than to, for example, foreign case law, it may well take the view that the trust law meaning of the term was not the meaning intended by the parties to the DTT. In a country like South Africa, where the role and status of the Commentary is still

¹⁷⁷² See ch 4.3.

¹⁷⁷³ However, see Du Toit's contrary view discussed in ch 8.6.1.

¹⁷⁷⁴ Commentary on the OECD MTC article 10 para 12.

¹⁷⁷⁵ Prebble (2004) 2 *eJournal of Tax Research* 9.

unclear, but the court is obliged to consider foreign precedent, it will be difficult to predict which of the two views a court will follow. It will be interesting to see whether any of the countries considered in this dissertation note a reservation against the proposed Commentary (if it is adopted). A reservation may indicate that a country prefers the view that the trust law meaning of the term should apply, with the result that a trust(ee) cannot be regarded as the beneficial owner of income for purposes of a DTT. It is submitted that, if a court decides to follow the proposed Commentary in relation to the “technical meaning” of the term, it should also follow the rest of the Commentary in determining whether a trust can be a beneficial owner.

In deciding which view a court will take, it may be tempting to argue that the decision in *Prévost* and Du Toit’s view are based on the trust law meaning of the term in common law, namely that a trustee, as legal owner, is not the beneficial owner of the trust property. Consequently, in South Africa, where there is no such distinction and where the trustee is the owner of the trust property, the decision in *Prévost* and Du Toit’s view should not be followed. However, it should be borne in mind that the decision in *Prévost* and Du Toit’s view are not based solely on the division of ownership found in common law trusts. Rather, it is based also on the fact that the trustee does not hold the trust property for his or her own benefit, but for the benefit of the beneficiaries. This feature of a trust lies at the heart of trust law in South Africa.¹⁷⁷⁶ Thus, the reasoning in *Prévost* and Du Toit’s contribution will apply equally to trusts subject to South African law.

It is submitted that, in order to determine whether a trust can be the beneficial owner, a South African court should investigate where the attributes of ownership (identified in *Prévost* and *Velcro* as possession, use, risk and control) lie in each case. The court in *Velcro* attributed the ordinary meaning of the word to each of these attributes and it is submitted that these meanings may be used to assess whether a trust holds the relevant ownership attribute.¹⁷⁷⁷

It is clear that in most cases the trustee will have possession¹⁷⁷⁸ of the income as the trustee usually receives and holds the income. In cases where the trustee accumulates income, it is evident that he or she also possesses the income. However, even in cases where the income is distributed to the beneficiaries soon after it was received by the trustee, it can be argued that the trustee had possession of the income. This is illustrated by the *Velcro* case, where VHBV were to pay an amount over to VIBV within 30 days after receipt of the royalties from VCI. VHBV was held to be the beneficial owner of the income.

In cases where the trustee may decide whether or not and to whom the income will be distributed, it may also be said that he or she has control¹⁷⁷⁹ over the income. An example of such a trust would be a South African discretionary trust, where the trustees may decide from year to year whether any distributions will be made and to which of the beneficiaries the distribution will be made. Therefore, even in a year in which the trustees decide to distribute all of the relevant income, they will still have control over the income, as they

¹⁷⁷⁶ See ch 2.2.4.

¹⁷⁷⁷ For ease of reference, the meaning attached to each attribute in the *Velcro* case is repeated here and is referred to as the *Velcro* meaning.

¹⁷⁷⁸ *Velcro* meaning: “having or holding property in one’s power” or “the exercise of dominion over property”.

¹⁷⁷⁹ *Velcro* meaning: “to exercise power or influence over”.

have the power to decide whether and to whom it will be distributed. In the case of a vesting trust, the trustees have no control over the income, as they are bound to hand it over to the beneficiaries as stipulated in the trust deed.

Risk¹⁷⁸⁰ as an attribute of ownership requires careful consideration. The meaning attached to the term in *Velcro* refers to the chance of or liability for injury, damage or economic loss. From a South African trust law perspective, it is important to note that only beneficiaries with a vested right to income are entitled to claim distribution of the income from the trustees. Discretionary beneficiaries, on the other hand, only have conditional rights against the trustee and it is only when (and if) the trustee exercises his or her discretion in favour of a beneficiary that the beneficiary becomes entitled to claim distribution of the income.¹⁷⁸¹ Therefore, discretionary beneficiaries do not know whether and if they will receive income from the trust in a specific year, until the trustee has exercised his or her discretion. When the discretion is exercised in favour of a beneficiary, that beneficiary acquires a vested right to the income. It is, therefore, submitted that a discretionary beneficiary does not carry any risk in relation to the income, because he or she has no unconditional right to the income. The risk is carried by the trust.¹⁷⁸² In a vesting trust the risk associated with the income lies in the hands of the beneficiary.

Regarding use¹⁷⁸³ as an ownership attribute, the formulation of the meaning adopted by the court in *Velcro* did not refer to use being for the trustee's own benefit. However, the court in *Prévost* formulated the test as follows: "the person who receives the dividends for *his or her own use and enjoyment* and assumes the risk and control of the dividend he or she received" (own emphasis). The court in *Velcro* derived the four attributes of ownership referred to above (namely possession, use, risk and control) from the judgement in *Prévost*. It is submitted that the attribute of use entails not only the employment or application of income, as suggested in *Velcro*, but also the enjoyment thereof. If read in this way, a person will only possess the use attribute of ownership if it is used and enjoyed for his or her own benefit. As stated earlier, a trustee rarely¹⁷⁸⁴ holds income for his or her own benefit and will, accordingly, not be able to claim this ownership attribute.

The test for beneficial ownership formulated in *Prévost* (and confirmed in *Velcro*) refers to the person who holds *all* the attributes of ownership. Thus, in terms of the *Prévost* test and applying South African law, a trust would never be regarded as the beneficial owner of income. However, Du Toit's formulation of the test entails that the person whose ownership

¹⁷⁸⁰ *Velcro* meaning: "the chance of injury, damage or loss' or 'liability for injury, damage or loss that occurs'. Reference here would be to economic loss."

¹⁷⁸¹ See ch 2.2.4.

¹⁷⁸² It is submitted that since a trust can be regarded as a person and a resident for purposes of a DTT (and because a trust is a person for domestic tax purposes), it has to be assessed whether the trust, and not the trustee, carries the risk associated with the income.

¹⁷⁸³ *Velcro* meaning: "the application or employment of something: a long continued possession or employment of a thing for which it is adapted."

¹⁷⁸⁴ In the case where a trustee is also a beneficiary of a trust, the trustee holds the income for his or her own benefit as beneficiary. However, in South Africa, a person can never be the sole trustee and sole beneficiary of a trust (see ch 2.2.4).

attributes outweigh those of all others, will be regarded as the beneficial owner.¹⁷⁸⁵ Regarding the meaning of outweigh, Du Toit opines as follows:

“Based on the case law above it seems fair to conclude that it is not so much a case of holding the biggest number of attributes but more a case of holding the biggest weight. Both the issues of the identification of the ownership attributes and determining who holds the biggest weight, depend on the specific circumstances ...”¹⁷⁸⁶

Therefore, if Du Toit’s view is followed, the different attributes of ownership should be weighed up against each other. In terms of the analysis above, three attributes will be held by the trust and one by the beneficiaries in the case of a discretionary trust. In the case of a vesting trust, only one attribute will be held by the trust and the others by the beneficiaries. Danon¹⁷⁸⁷ is of the view that the power to control the attribution of income is the most important ownership attribute. He argues that the fact that a trustee does not use and enjoy the income for his or her own benefit is not decisive.¹⁷⁸⁸ If this view is followed, it seems that the scales would tip in favour of the trust as beneficial owner in the case of a discretionary trust, but that the beneficiaries would be the beneficial owners in the case of a vesting trust.

Thus, if one started by considering which person holds the relevant ownership attributes, the line of reasoning outlined above (using Du Toit and Danon’s views) would have to be followed through to conclude that a trust (or the trustee) will, in the case of a discretionary trust, be regarded as the beneficial owner of the income for DTT purposes. If this reasoning is applied, the same conclusion as that set out in the proposed Commentary is reached in respect of discretionary trusts that accumulate income. However, if the proposed Commentary is applied to trusts that distribute income in the same year in which it is acquired, the conclusion was reached that these trusts are not the beneficial owners of the income for DTT purposes. The difference between the two views lies in the fact that, in terms of the proposed Commentary, the trustee is (after the exercise of his or her discretion) obliged to pay the income to the beneficiary. If, however, it is borne in mind that the trustee has control over whether or not they will create this obligation, it is submitted that the argument outlined above (using Du Toit and Danon’s views) is the preferred one.¹⁷⁸⁹

8.7 Conclusion

8.7.1 General

The meaning of the term beneficial owner has been uncertain from the time that it was incorporated in the OECD MTC. Many authors have expressed an opinion regarding the meaning of the term. Most of them agree that the term should not be interpreted in

¹⁷⁸⁵ See ch 8.5.

¹⁷⁸⁶ Du Toit *Beneficial Ownership of Royalties in Bilateral Tax Treaties* 201.

¹⁷⁸⁷ See ch 8.6.1.

¹⁷⁸⁸ Schwarz holds a contrary view, namely that beneficial ownership has nothing to do with control and that beneficial enjoyment is an important feature of beneficial ownership. His view is based on the United Kingdom domestic law meaning of the term beneficial owner (Schwarz *Schwarz on Tax Treaties* 314).

¹⁷⁸⁹ The practical problem (encountered when a trustee of a discretionary trust decides to distribute income to a beneficiary within the same tax year, but after some time has lapsed) which arises when the proposed Commentary is applied will not occur if the argument based on the most important ownership attributes is followed.

accordance with domestic law, but that an international fiscal meaning should be attached to it. Case law, such as *Indofood*, supports this point and the Commentary and proposed Commentary also indicate that the international fiscal meaning should be followed.

In South Africa, academic authors are of the view that a domestic meaning should not be attached to the term and that no sensible domestic law meaning can be found in domestic law which could be used for purposes of a DTT. It is submitted that the courts in the United Kingdom and Canada will favour the use of an international fiscal meaning of the term. The only state considered in this study to rely on a domestic law meaning of the term is the Netherlands.

The OECD's Commentary on the meaning of the term was very limited when the term was first incorporated into the OECD MTC. After the Conduit Companies Report, the Commentary was expanded in 2003 and according to some commentators this expansion not only changed the meaning of the term, but also increased the uncertainty surrounding the meaning of the term.¹⁷⁹⁰ The proposed Commentary aims to clarify the interpretation that should be given to the term in the context of the OECD MTC.¹⁷⁹¹ Whether this aim will be achieved, remains to be seen. Prominent cases, such as *Indofood* and *Prévost*, have referred to the OECD Commentary, indicating its importance in the interpretation of the term. It is submitted that the OECD Commentary offers an international fiscal meaning to the term beneficial owner. The weight that a court will attach to this meaning will depend on its view regarding the status and role of the Commentary.

The case law on beneficial ownership has increased in recent years, signalling that the meaning of the term is an important issue in interpreting DTTs. The leading cases suggest that the absence of an agent or nominee relationship does not conclude the beneficial owner question. Furthermore, the cases look to the person who has all the attributes of ownership to determine who the beneficial owner is. The courts will consider an entity to be a mere conduit only if it has absolutely no discretion as to the use or application of funds put through it, or if it has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs. In applying these tests, some courts apply a legal test only, in other words, only the parties' rights and obligations are considered. Other courts apply a substance over form or practical matter or economic test, either on its own, or in addition to the legal test. Courts agree that the motive to avoid tax is not a factor which should be taken into account to determine the beneficial owner of income.

Academic authors have expressed differing views on the meaning of beneficial ownership. Some authors' views are focussed on the agent or nominee roles and conduit company approach set out in the OECD Commentary, while other authors focus on the attributes of ownership.

¹⁷⁹⁰ Collier (2011) 6 BTR 684 690.

¹⁷⁹¹ OECD *Clarification of the Meaning of "Beneficial Owner" in the OECD Model Tax Convention: Discussion Draft 2*.

8.7.2 Can a trust be the beneficial owner of income?

Regarding the question of whether a trust (or trustee) can be the beneficial owner of income, most academic authors agree that at least some trusts (or its trustee) may be beneficial owners. Case law, on the other hand, suggests that a trust (or trustee) cannot be a beneficial owner, as income is not held for the benefit of the trust (or trustee), but for the benefit of the beneficiary.

The OECD's revised proposals make it clear that the trust law meaning of the term, as used in common law states, is not the intended meaning of the term in the OECD MTC. It furthermore explicitly states that a trust (or trustee) may be the beneficial owner of income for purposes of a DTT and gives an example of where this may occur. Regarding the further point made in the proposed Commentary, it is to be noted that in none of the states under consideration in this dissertation will a trust (or the trustee) be regarded as an agent or a nominee of the beneficiaries. It is submitted that a trust (or trustee) could be regarded as a conduit and it should therefore be investigated whether a trust has very narrow powers which render the trust (or trustee) a mere administrator or fiduciary. If the trust's (or trustee's) right to use and enjoy the income is constrained by a contractual or legal right to pass the income on to another, it will not be regarded as the beneficial owner. Consequently it is submitted that in the case of vesting trusts or some discretionary trusts in which the trustee distributes the income to the beneficiaries in the same tax year that the income flowed into the trust, the trust will not be regarded as the beneficial owner. It is further submitted that if the trustee accumulates the income (and irrespective of whether it is distributed in a later year), the trust may be regarded as the beneficial owner of the income.

The case law and the OECD Commentary therefore seem to be in conflict and it is submitted that the court's view of the role and status of each in the interpretation of actual treaties will be decisive in determining which view is followed.

It is submitted that in order to determine whether a trust can be the beneficial owner, a South African court should inquire which attributes of ownership the trust holds. In the case of a vesting trust, only the attribute of possession will be in the hands of the trust and then only until it is paid over to the beneficiary.¹⁷⁹² In the case of a discretionary trust, the attributes of possession, control and risk rest in the hands of the trust, but the attribute of use is in the hands of the beneficiary. Case law would demand that all of the ownership attributes be held by the trust before it can be regarded as the beneficial owner, but academic authors suggest that these attributes should be weighed in each case and that the attribute of control carries the most weight in the trust scenario. According to this view, a discretionary trust would hold the biggest weight of ownership attributes and therefore be regarded as the beneficial owner. The opposite would be true in the case of a vesting trust. It is submitted that this view is the preferred one and should be applied by a South African court. Such an argument also corresponds with the conclusion reached by applying the proposed Commentary in respect of discretionary trusts that accumulate income (but not for all trusts which distribute income in the same year in which it was acquired).

¹⁷⁹² It is submitted that it is irrelevant whether this time period is short or long.

8.7.3 The different states

Academic authors opine that a domestic meaning should not be attached to the term beneficial owner and that no workable domestic law meaning can be found which could be used for purposes of a DTT. It is submitted that South Africa should apply a test for beneficial ownership based on the person whose ownership attributes outweigh those of others. According to this view, in the case of a vesting trust, the beneficiaries will be the beneficial owners and in the case of a discretionary trust, the trust will be the beneficial owner.

In the United Kingdom, if the domestic law meaning of the term is applied, the trustee will not be regarded as the beneficial owner, but rather the beneficiary. If, however, a court follows an international fiscal meaning (as, it is submitted, it should) and if it follows *Indofood*, the trustee will not be regarded as the beneficial owner. If, however, sufficient weight is attached to the Commentary, or if the court is persuaded by the argument based on the weighing up of ownership attributes set forth above, it may regard the trustee as beneficial owner.

If the Canadian courts apply a domestic law meaning to the term beneficial owner, a trustee will not be regarded as the beneficial owner. The courts in Canada will also be bound (or might be persuaded) by the decision in *Prévost*. In terms of that decision a trust will not be regarded as the beneficial owner of income. It, therefore, seems unlikely that in Canada a trust will be regarded as the beneficial owner of income.

The Netherlands will apply its domestic law definition of beneficial owner to the relevant income.

8.7.4 Closing remarks

No consensus exists regarding the meaning of the term beneficial owner and it is difficult to reconcile the views of academic authors, case law and the OECD as set forth in the Commentary. However, it is submitted that an argument can be made that a discretionary trust should be regarded as the beneficial owner of income, at least in circumstances in which the income is accumulated.

Annexure to Chapter 8

Proposed amendments to the Commentary on article 10

The quote below indicates the proposed amendments to the Commentary on article 10 (similar amendments being proposed for the Commentary to articles 11 and 12) and also indicates the amendments made in reaction to the comments received on the first draft (that is, the April 2011 draft):

“3. Replace paragraphs 12 to 12.2 of the Commentary on Article 10 by the following:

12. The requirement of beneficial owner was introduced in paragraph 2 of Article 10 to clarify the meaning of the words “paid ... to a resident” as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over dividend income merely because that income was ~~immediately received by~~ **paid direct to** a resident of a State with which the State of source had concluded a convention. [*The rest of the paragraph has been moved to new paragraph 12.1.*]

12.1 Since the term ‘beneficial owner’ was added to address potential difficulties arising from the use of the words ‘paid to ... a resident’ in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term ‘beneficial owner’ is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries¹), rather, it should be understood in its context, in particular in relation to the words ‘paid ... to a resident’, and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance. ~~This does not mean, however, that the domestic law meaning of “beneficial owner” is automatically irrelevant for the interpretation of that term in the context of the Article: that domestic law meaning is applicable to the extent that it is consistent with the general guidance included in this Commentary.~~

[Footnote to paragraph 12.1]

1. For example, where the trustees of a discretionary trust do not distribute dividends earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer), could constitute the beneficial owners of such income for the purposes of Article 10 even if they are not the beneficial owners under the relevant trust law notwithstanding that the relevant trust law might distinguish between legal and beneficial ownership.

~~12.12~~ Where an item of income is ~~received by~~ **paid to** a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the ~~immediate~~ **direct** recipient of the income as a resident of the other Contracting State. The ~~immediate~~ **direct** recipient of the income in this

situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence. [*The rest of the paragraph has been moved to new paragraph 12.3.*]

12.3 It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled ‘Double Taxation Conventions and the Use of Conduit Companies’¹ concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

[Footnote to paragraph 12.3]

1. Reproduced at page R(6)-1 of Volume II of the **full-length** loose-leaf version of the OECD Model Tax Convention.

12.4 *In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the recipient of the dividend is not the ‘beneficial owner’ because that recipient’s right to use and enjoy the dividend is constrained—that recipient does not have the full right to use and enjoy the dividend that it receives and this dividend is not its own; the powers of that recipient over that dividend are indeed constrained in that the recipient is obliged (because of a contractual, fiduciary or other duty) to pass the payment received to another person. The recipient of a dividend is the “beneficial owner” of that dividend where he has the full right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the full right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation must be related to the payment received; it would therefore not include contractual or legal obligations unrelated to the payment received even if those obligations could effectively result in the recipient using the payment received to satisfy those obligations. Examples of such unrelated obligations are those unrelated obligations that the recipient may have as a debtor or as a party to financial transactions or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1. Where the recipient of a dividend does have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the ‘beneficial owner’ of that dividend. It should also be noted that Article 10 refers to the beneficial*

owner of a dividend as opposed to the owner of the shares, which may be different in some cases. ~~also, the use and enjoyment of a dividend must be distinguished from the legal ownership, as well as the use and enjoyment, of the shares on which the dividend is paid.~~

12.5 The fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraphs 17 and 22 below). As explained in the section on 'Improper use of the Convention' in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific ~~treaty~~ anti-abuse provisions in treaties, general anti-abuse rules and substance-over-form or economic substance approaches. Whilst the concept of 'beneficial owner' deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

12.6 The above explanations concerning the meaning of 'beneficial owner' make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments¹ that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of 'beneficial owner' cannot be applied in the context of the Article. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 (a), which refers to the situation where a company is the beneficial owner of a dividend. ~~Since,~~ In the context of Article 10, the term 'beneficial owner' is intended to address difficulties arising from the use of the words 'paid to' in relation to dividends, rather than difficulties related to the ownership of the shares of the company paying these dividends. For that reason, it would be inappropriate, in the context of that Article, to consider a meaning developed in order to refer to the individuals who exercise 'ultimate effective control over a legal person or arrangement'.²

[Footnotes to paragraph 12.6]

1. See, for example, Financial Action Task Force, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations (OECD-FATF, Paris, 2012), ~~the Glossary to the Financial Action Task Force's Forty Recommendations~~ (http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html#34276864) which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 109): 'the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons

who exercise ultimate effective control over a legal person or arrangement.’ Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, ‘Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes’ (OECD, Paris, 2001), <http://publications.oecd.org/acrobatebook/2101131E.PDF>, at page 14, defines beneficial ownership as follows (at page 14):

In this Report, ‘beneficial ownership’ refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.

2. See the Financial Action Task Force’s definition quoted in the previous note. ~~Glossary to the Financial Action Task Force’s Forty Recommendations~~ (~~http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html#34276864~~).

12.72 Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 **and in [year of next update]** to clarify this point, which has been the consistent position of all Member countries). ~~States which wish to make this more explicit are free to do so during bilateral negotiations.~~¹⁷⁹³

¹⁷⁹³ OECD OECD Model Tax Convention: Revised Proposal Concerning the Meaning of “Beneficial Owner” in Articles 10, 11 and 12 17–20.

CHAPTER 9

CONCLUSION

Chapter overview	295
9.1 Introduction	296
9.2 Nature and key features of a trust	296
9.3 The taxation of trusts	297
9.4 The interpretation and status of tax treaties	298
9.5 Is the trust a person for purposes of the OECD MTC?	299
9.6 The residence of a trust for purposes of the OECD MTC	301
9.7 Attribution of income to a trust	305
9.8 Beneficial ownership and the trust	306
9.9 The trust and the OECD MTC from a South African perspective	308
9.10 Examples	309
9.11 Closing remarks	312

9.1 Introduction

The question posed at the start of this dissertation is how a court would interpret and apply certain critical provisions of a Double Taxation Treaty (DTT) to a trust, assuming that South Africa is a party to the DTT and that the DTT is patterned on the Organisation for Economic Co-operation and Development Model Tax Convention (OECD MTC). In this chapter the findings and recommendations of the dissertation are compiled in an attempt to answer the question posed above. Finally, the findings are used in a number of examples, to illustrate how these findings may be applied.

9.2 Nature and key features of a trust

It is not feasible to study the taxation of trusts and the way in which trusts are to be treated in terms of international treaties (like the OECD MTC) without having regard to the law applicable to trusts and, especially, their nature. The dissertation therefore started off by considering the legal position of trusts in South Africa, the United Kingdom, Canada and the Netherlands. In the case of the United Kingdom, a distinction was made between England and Scotland and in the case of Canada, the distinction was between the rest of Canada and Québec. Regarding the Netherlands, it was acknowledged that the English law trust is not traditionally found in Dutch law and that certain trust-like institutions fulfil the role performed by the trust in other jurisdictions. However, the Netherlands acceded to The Convention on the Law Applicable to Trusts and on their Recognition ("The Hague Convention on Trusts")¹⁷⁹⁴ and is therefore obliged to recognise trusts created in other jurisdictions.¹⁷⁹⁵ Although the chapter as a whole serves as a background to the rest of the dissertation, there are a number of aspects regarding trusts that are particularly important for purposes of this dissertation. These aspects influence the treatment of trusts for tax purposes, not only in a particular state's domestic legislation, but also at a DTT level.

Most significantly, a trust is not regarded as a juristic person in any of the above jurisdictions.¹⁷⁹⁶ Despite this, a trust is regarded as a taxable entity in South Africa¹⁷⁹⁷ and Canada¹⁷⁹⁸ by legislation. In the United Kingdom, the trustees are regarded as a single person for income tax purposes, distinct from the persons who are the trustees from time to time.¹⁷⁹⁹

Furthermore, in all the jurisdictions discussed in this dissertation (except Québec) the trustees are the owners of the trust assets.¹⁸⁰⁰ In England and the rest of Canada, the trustees are the legal owners of the trust property. The beneficiaries in vested trusts have equitable or beneficial ownership, whilst beneficiaries in discretionary trusts have a proprietary interest in the wider sense or a "*quasi-property interest*".¹⁸⁰¹ No such split in ownership is known in South Africa, Scotland or Québec. The beneficiaries of trusts in South

¹⁷⁹⁴ Convention on the Law Applicable to Trusts and on their Recognition .

¹⁷⁹⁵ See ch 2.5.

¹⁷⁹⁶ See ch 2.7.

¹⁷⁹⁷ See chs 2.2.3, 3.2.1 and 5.4.

¹⁷⁹⁸ See chs 3.4.1 and 5.2.4

¹⁷⁹⁹ See chs 3.3.1, 5.2.3, 5.5 and 6.2.2.2.

¹⁸⁰⁰ See ch 2.7.

¹⁸⁰¹ See chs 2.3.3.1 (England) and 2.4.4.1 (Canada).

Africa and Scotland do not have any form of ownership in the trust property.¹⁸⁰² Instead they have personal rights against the trustee.¹⁸⁰³ In South Africa, England,¹⁸⁰⁴ Scotland¹⁸⁰⁵ and the rest of Canada,¹⁸⁰⁶ the trust assets form a separate estate or patrimony in the hands of the trustees and are safe from the trustees' personal creditors. Trustees are also under a duty to keep trust assets separate from their own assets.

In none of the states considered in this dissertation is a trust equated to an agent. Furthermore, it is submitted that a trustee is not an agent of either the settlor or the beneficiary in any of these states.¹⁸⁰⁷

It is also important to note that all of the jurisdictions discussed in this dissertation recognise the difference between vesting (or fixed) trusts and discretionary trusts¹⁸⁰⁸ and that the rights of the beneficiaries under each of these two types of trusts are different.¹⁸⁰⁹ This distinction is significant, since most states under consideration treat these types of trusts differently for tax purposes and it is submitted that these types of trusts will also be treated differently for purposes of a DTT modelled on the OECD MTC.

In all of the relevant jurisdictions, the administration of the trust is in the hands of the trustee. In South Africa, England and the rest of Canada the trustees may delegate some of their less vital functions, but not the more important ones. In Québec delegation of general administration or exercise of a discretionary power may take place, but only to co-trustees. In Scotland an agent may be appointed, if appropriate.¹⁸¹⁰

It is submitted that these aspects of trust law, in particular, are essential considerations in applying the OECD MTC to trusts. These aspects determine, or at least influence, the issues that are considered in this dissertation, namely whether a trust (or trustee) will be regarded as a person, a resident or a beneficial owner for purposes of the OECD MTC.

9.3 The taxation of trusts

A further vital part of the framework of this dissertation is to ascertain how each of the states tax trusts. Although all of the states follow the same basic taxation policy, namely that income flowing through a trust should be taxed only once, the states use different mechanisms to achieve this aim.¹⁸¹¹ South Africa uses mainly an initial choice system, which entails that, as income arises, a choice is made whether to tax the beneficiary or the trust. The choice is based on whether the beneficiary has a vested or contingent right to the income.¹⁸¹² Significantly, in South Africa, the trust itself is a person for tax purposes and

¹⁸⁰² However, in the South African *bewind* trust the beneficiary is the owner of the assets, but this type of trust is excluded from the scope of this dissertation.

¹⁸⁰³ See chs 2.2.4 (South Africa), 2.3.3.2 (Scotland) and 2.4.4.2 (Québec).

¹⁸⁰⁴ See ch 2.3.3.1.

¹⁸⁰⁵ See ch 2.3.3.2.

¹⁸⁰⁶ See ch 2.4.4.1.

¹⁸⁰⁷ See ch 2.7.

¹⁸⁰⁸ The exception is Québec where the Civil Code is silent on this issue.

¹⁸⁰⁹ See chs 2.2.4 (South Africa), 2.3.3.1 (England), 2.3.3.2 (Scotland) and 2.4.4.1 (Canada).

¹⁸¹⁰ See ch 2.7.

¹⁸¹¹ See ch 3.1.

¹⁸¹² See ch 3.2.2.

therefore liable to tax as a taxpayer. The United Kingdom predominantly uses the credit method, which involves that both the trustee and the beneficiary are taxed on the income, but the beneficiary is granted a credit for the taxes paid by the trustee.¹⁸¹³ In the United Kingdom, it is the trustee that is regarded as a distinct person for tax purposes. In Canada, primarily the deduction method is used, which means that although income is taxed in the hands of the trust and distributions are again taxed in the hands of the beneficiary, the trust is granted a deduction for the amount distributed to the beneficiary. According to the Canadian Income Tax Act,¹⁸¹⁴ a trust is deemed to be an individual and the trust itself is therefore liable to tax.¹⁸¹⁵ The Netherlands introduced the concept of *afgezonderd particulier vermogen* (APV) in 2010. Most discretionary trusts will be classified as APVs, with the result that all the income of the APV is taxed in the hands of the settlor.¹⁸¹⁶

It should be noted that all of the states considered in this dissertation tax discretionary trusts differently from vesting (or fixed) trusts. The rights of the beneficiaries, determined according to trust law principles, are therefore crucial in determining how the trust and other role players are to be taxed. Tax avoidance is also uppermost in the minds of the taxing authorities in all of these states, as they all have anti-avoidance legislation specifically aimed at curbing avoidance through the use of trusts and all these states use high tax rates in respect of trusts.¹⁸¹⁷ Generally, in none of the states considered in this dissertation are trusts subject to the same tax treatment as individuals or companies and a unique regime is usually enacted to deal with the taxation of trusts.¹⁸¹⁸

The way in which each state imposes tax on trusts is governed by the policy decisions made by that state. These choices influence the way in which each state will apply DTTs modelled on the OECD MTC to trusts. More specifically, how the domestic tax law of a particular state taxes trusts (or trustees), will determine whether it will be regarded as a person or a resident for purposes of the DTT or whether it could possibly be regarded as the beneficial owner of income. Furthermore, domestic tax law regulates the attribution of income for DTT purposes. It is submitted that policy makers should bear in mind the effect that their choices regarding domestic taxation of trusts has on the treatment of trusts under DTTs. This point is especially pertinent for South Africa, where policies are still in the process of being brought into line with South Africa's re-emergence into the global economy.

9.4 The interpretation and status of tax treaties

To further contextualise the discussion regarding the application of the selected provisions of the OECD MTC to trusts, the way in which each state interprets DTTs entered into by it and the status afforded to DTTs in each state were investigated. Many of the matters that have been dealt with in the other states under discussion still remain unresolved in South Africa. Thus, although it is clear that South Africa is not a signatory to the Vienna Convention on the Law of Treaties (Vienna Convention),¹⁸¹⁹ it is unclear whether the provisions of this

¹⁸¹³ See ch 3.3.7.

¹⁸¹⁴ Income Tax Act RSC 1985 (5th supp) ch 1 s 104(2).

¹⁸¹⁵ See ch 3.4.7.

¹⁸¹⁶ See ch 3.5.2.

¹⁸¹⁷ See ch 3.6.

¹⁸¹⁸ See ch 5.3.

¹⁸¹⁹ The Vienna Convention contains rules regarding the interpretation of treaties.

Convention form part of South African law as customary international law. The other relevant states are all signatories to the Vienna Convention.¹⁸²⁰ In South Africa the courts' reliance on the OECD Commentary is erratic. Sometimes, even though there is relevant Commentary or OECD reports, these are not referred to in judgements. In other cases where the OECD MTC or the Commentary is mentioned, the basis on which this is done is not stated.¹⁸²¹ It is submitted that neither section 232 nor section 233 of the Constitution¹⁸²² provides a basis to refer to the OECD MTC or the Commentary, as neither of these latter instruments is international law.¹⁸²³ In the other relevant states, the courts have indicated that the Commentary plays an important role in the interpretation of DTTs.¹⁸²⁴ Although it is not stated clearly by the courts, an examination of the judgements shows that South African courts generally attribute an autonomous treaty meaning to the wording of a DTT.¹⁸²⁵ In the other three states, the courts have explicitly stated that they will apply an autonomous treaty meaning.

Furthermore, there are differing opinions regarding the process by which DTTs become part of South African law. Moreover, it is not yet settled whether a DTT outranks the other provisions of the Income Tax Act.¹⁸²⁶ At least three views can be identified from the cases, namely that (a) the Income Tax Act must prevail, (b) a DTT modifies domestic law and will apply in preference to domestic law in the case of conflict, and (c) the legislation and treaty rank equally and any conflict must be resolved by the application of the principles of statutory interpretation and superseding legislation. Although the view set out in (c) is preferred, it is submitted that the view set out in (b) will probably be followed by the courts in relation to DTTs.¹⁸²⁷

It is hoped that the South African courts will take notice of the uncertainty surrounding the basis on which courts may refer to the Commentary and the status of South Africa's tax treaties and provide guidance on these points. The courts or the legislature have done so in the other states under discussion.

9.5 Is the trust a person for purposes of the OECD MTC?

A state applying a DTT based on the OECD MTC will have to determine, *inter alia*, whether a trust (or trustee) is a person or a resident and the beneficial owner of the income (if relevant). In addition, it will have to determine whether the income is attributed to the trust (or trustee). If any of these requirements is not met, the trust (or trustee) cannot rely on the DTT.

Regarding the first of these requirements, namely that the trust (or the trustee) must be a person, the OECD seems to indicate, in its Collective Investment Schemes Report,¹⁸²⁸ that if a trust (or trustee) is treated as a taxpayer in the state in which it is established, it should be

¹⁸²⁰ See ch 4.3.1.

¹⁸²¹ See ch 4.3.2.2.

¹⁸²² Constitution of the Republic of South Africa 1996.

¹⁸²³ See ch 4.3.2.1.

¹⁸²⁴ See chs 4.3.3 (United Kingdom); 4.3.4 (Canada) and 4.3.5 (the Netherlands).

¹⁸²⁵ See ch 4.3.2.2.

¹⁸²⁶ Income Tax Act 58 of 1962.

¹⁸²⁷ See chs 4.4.1 and 4.5.

¹⁸²⁸ OECD R(24). *The granting of treaty benefits with respect to the income of collective investment vehicles*.

regarded as a person. However, no reasons are provided for this view, save to say that as a matter of policy, such trusts should be regarded as persons.¹⁸²⁹ In this dissertation, the relevant provisions of the OECD MTC were therefore analysed to determine whether a trust (or trustee) can be regarded as a person in each of the states discussed herein.

Based on the wording of the OECD MTC, it was established that a trust (or trustee) may qualify as a person if it falls within any one of the following criteria:

- (a) an individual;
- (b) any other body of persons;
- (c) any body corporate;
- (d) an entity that is treated as a body corporate for tax purposes; or
- (e) the ordinary meaning of the term person.¹⁸³⁰

In South Africa, the trust is neither an individual, nor a body corporate. In relation to the question whether a trust could be a body of persons, it was concluded that if the domestic law meaning of the term were to apply,¹⁸³¹ a trust would not be regarded as a body of persons in terms of case law, but a trustee could.¹⁸³² If, in terms of article 3(2) of the OECD MTC, the context requires that the domestic law meaning be disregarded and the ordinary meaning of the term be applied, the trust will still not be regarded as a body of persons, but the trustee will. If, under these circumstances, an international fiscal meaning were to be attached to this term, one was (hesitantly) offered in this dissertation, but it was concluded that arguing that a trust is a person because it falls within the international fiscal meaning, cannot be done with much confidence.¹⁸³³ It was ascertained that the phrase “an entity that is treated as a body corporate for tax purposes” means entities that are treated like juristic persons under the tax laws of any of the contracting states. A trust (or trustee) is not treated like a juristic person in terms of South African tax law and can therefore not be a person in terms of this criterion.¹⁸³⁴ The only criterion in terms of which a trust can be regarded as a person is the ordinary meaning of the term. If the domestic law meaning of the term is used to complete the definition of the term person, a trust will be regarded as a person, because the South African Income Tax Act includes a trust in its definition of the term person.¹⁸³⁵ It is recommended that, to place the matter beyond any doubt, South Africa should routinely include a trust specifically in the definition of person in the DTTs concluded with other countries.¹⁸³⁶

Applying the same criteria to the United Kingdom, it was concluded that a trust is not a person, but that the trustee is. In Canada, both the trust and the trustee will be regarded as

¹⁸²⁹ See ch 5.1.

¹⁸³⁰ See ch 5.1.

¹⁸³¹ Via art 3(s) of the OECD MTC.

¹⁸³² See ch 5.2.2.

¹⁸³³ See ch 5.2.6.

¹⁸³⁴ See ch 5.3.

¹⁸³⁵ See ch 5.4.

¹⁸³⁶ See ch 5.7.

persons. Although it is doubtful, the trustees of a trust might be regarded as a body of persons and therefore a person in the Netherlands.¹⁸³⁷

9.6 The residence of a trust for purposes of the OECD MTC

Regarding the second requirement, namely that the trust (or trustee) be regarded as a resident, the provisions of article 4(1) are of the utmost importance. Only if a trust (or trustee) is liable to tax by reason of the listed criteria in terms of the domestic law of the state, will it be a resident of that state. Since residence is determined by domestic law, it was deduced that each state's domestic law should be used to determine whether it is the trust or the trustee that can be resident in that state. It was concluded that in South Africa and Canada, the relevant person who is liable to tax in terms of domestic law is the trust itself, while in the United Kingdom, it is the trustees, as a body, that is liable to tax in terms of domestic law. It is therefore the trust in South Africa and Canada and the trustees (as a body) in the United Kingdom, who are persons for purposes of article 1 and whose residence should be determined for purposes of article 4(1).¹⁸³⁸

If a state treats an entity as fiscally transparent, it is not liable to tax and therefore cannot be regarded as a resident of a contracting state.¹⁸³⁹ Certain degrees of transparency were noted and the question was raised as to the degree of transparency that was required for an entity to be regarded as either transparent or opaque. It was argued that trusts (or trustees) that are completely transparent (whether or not they have certain reporting requirements) are not liable to tax and can therefore not be residents of the particular state. A trust (or trustee) that is completely opaque is liable to tax and can therefore be regarded as a resident for DTT purposes.¹⁸⁴⁰ The more difficult case is that of a partially transparent trust (or trustee). After considering the domestic taxation of a trust (or trustee) in the relevant states, it was concluded that there is merit in regarding a partially transparent trust (or trustee) as liable to tax, even in circumstances where all its income is distributed. However, the following approach is preferred, because it is more practical: a trust (or trustee) that is taxed on undistributed income, is liable to tax in relation to that income. Regarding that portion of the income that is taxed in the hands of the beneficiaries, the beneficiaries resident in the relevant countries are entitled to the benefits of the applicable conventions, to the extent that they are liable to tax on the income distributed to them.¹⁸⁴¹

The fact that anti-avoidance legislation attributes the trust income to another person, does not influence the trust's (or trustee's) liability to tax.¹⁸⁴²

The words "by reason of his domicile, residence, place of management or any other criterion of a similar nature" in article 4(1) were interpreted in the Canadian case of *Crown Forest Industries Ltd v The Queen*.¹⁸⁴³ According to this case there should be a causal link or some relationship of proximity between the grounds for tax liability in a state and the criteria

¹⁸³⁷ See ch 5.7.

¹⁸³⁸ See ch 6.2.2.2.

¹⁸³⁹ See ch 6.2.2.3.1.

¹⁸⁴⁰ See ch 6.2.2.3.2.

¹⁸⁴¹ See ch 6.2.2.3.3.

¹⁸⁴² See ch 6.2.2.4.

¹⁸⁴³ *Crown Forest Industries Ltd v The Queen* [1995] 2 SCR 802.

enumerated in article 4(1). The case furthermore indicates that the listed criteria connote comprehensive liability imposed by a state and that any basis of taxation which is to be classified as a “criterion of a similar nature” should also involve comprehensive liability and not just source-based taxation. The *Crown Forest Industries* case may provide guidance to a South African court if it were asked to interpret similar words in one of South Africa’s DTTs. In relation to trusts it is relevant whether the criterion of “established or formed” (one of the grounds on which a trust will be resident in terms of South African domestic law) will be regarded as of a similar nature to the other criteria enumerated in article 4(1). Although there are differing views in the academic literature, it was argued in this dissertation, based on the decision in *Crown Forest Industries*, that the view that this criterion is of a similar nature (since it leads to comprehensive taxation) is to be preferred. It was argued that, in any event, the criterion of “established or formed” merely indicates that a trust is resident in South Africa and that residence is one of the criteria listed in article 4(1). However, to put the matter beyond doubt, it may be advisable for South Africa to enter a reservation to article 4 to indicate that it will apply the criterion of “established or formed” in relation to trusts.¹⁸⁴⁴

Since article 4(1) requires that residence be determined in accordance with domestic law, it was examined how the residence of a trust(ee) is determined in terms of the domestic law of each of the states discussed in this dissertation. South Africa uses two alternative criteria to establish a trust’s residence.¹⁸⁴⁵ One of these criteria is “established or formed in the Republic”. There are at least two ways to interpret this phrase, with strong arguments in favour of both. The interpretation preferred in this dissertation is that a trust is established or formed in South Africa if it is established or formed within South Africa’s borders, but it is recommended that the legislation be amended to clarify this point.¹⁸⁴⁶

In academic literature there is a debate regarding the time when an *inter vivos* trust is formed or established for purposes of the definition of “resident” in the South African Income Tax Act. The preferred view is that a trust is established or formed on the date that the settlor and trustee sign the trust deed (or enter into an oral agreement), irrespective of the date on which the beneficiary accepts. Although it is submitted that the arguments in favour of the other view is not as convincing, it is recommended that the legislation be amended to clarify this point. Since an *inter vivos* trust is created by way of a contract, the rules on the place of formation of a contract (both for an electronic contract and one in the more traditional paper form) were examined. In respect of electronic contracts it was concluded that the default rule in the Electronic Communications and Transactions Act¹⁸⁴⁷ regarding the place of formation may result in uncertainties when the place of formation of a trust has to be determined. It was therefore recommended that parties should stipulate in a trust instrument that is sent electronically exactly where the agreement will be concluded.¹⁸⁴⁸

¹⁸⁴⁴ See ch 6.2.3.

¹⁸⁴⁵ Income Tax Act 58 of 1962 s 1 definition of “resident”.

¹⁸⁴⁶ See ch 6.3.1.2.1.

¹⁸⁴⁷ Electronic Communications and Transactions Act 25 of 2002.

¹⁸⁴⁸ See ch 6.3.1.2.2.

A testamentary trust is usually formed at the date of the testator's death and it is submitted that it is formed at the place where the testator executes the will by which the trust is formed.

A trust is not "established" or "formed" through the registration of the trust instrument, or the authorisation of the trustees by the Master. These formal acts by the Master are, consequently, irrelevant in determining a trust's residence.¹⁸⁴⁹

It seems that if the rules on the formation of trusts are applied in order to determine their residence, the place of "formation" or "establishment" may be either arbitrary or easily manipulated. One answer would be to amend the Income Tax Act in such a way that a trust will be resident in South Africa if registration of the trust instrument and authorisation of trustees are required in terms of the Trust Property Control Act.¹⁸⁵⁰ However, this solution would not apply to oral trusts which are not covered by that Act.¹⁸⁵¹

The other criterion used to determine whether a trust is resident in South Africa in terms of its domestic law is that of place of effective management (POEM). There are many uncertainties regarding the meaning of the term POEM. For example, it is uncertain whether the term POEM in the Income Tax Act bears the same meaning as the term used in article 4(3) of the OECD MTC. This dissertation supports the view that the terms do have the same meaning in that the meaning in terms of South Africa's DTTs (which are based on the OECD MTC) informs the meaning of the term in the Income Tax Act.¹⁸⁵² It is also uncertain what the South African Revenue Service's view is regarding the meaning of POEM.¹⁸⁵³ What is certain, though, is that its view is not law and therefore not binding on the taxpayers or the courts. Academic authors have also offered differing views regarding the meaning of POEM. Some guidance is provided by the *Commissioner for the South African Revenue Service v Tradehold Ltd*¹⁸⁵⁴ and *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service*¹⁸⁵⁵ cases. It can be deduced from these cases that the place of decision making, and not the place where decisions are implemented, is relevant in determining the POEM. Furthermore, both cases indicate that the top level of management is the level of management relevant to determine POEM. In these respects it is submitted that the South African domestic law meaning of the term POEM corresponds in broad terms to the position set out in the OECD Commentary to article 4(3).¹⁸⁵⁶

Applying these cases to trusts, it is submitted that the top level of management is usually exercised by the trustees. If the trustees do indeed exercise the effective management of the trust, it is the place where they take their decisions that will determine the POEM of the trust. The facts may, however, indicate that the effective management of the trust is not exercised by the trustees, in which case it is the place where the person that effectively

¹⁸⁴⁹ See ch 6.3.1.2.2.

¹⁸⁵⁰ Trust Property Control Act 57 of 1988.

¹⁸⁵¹ See ch 6.3.1.2.2.

¹⁸⁵² See ch 6.3.1.3.1.

¹⁸⁵³ See ch 6.3.1.3.2.

¹⁸⁵⁴ *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

¹⁸⁵⁵ *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* 74 SATC 127.

¹⁸⁵⁶ See ch 6.3.1.3.3.

manages the trust takes the decisions that will be relevant in determining the trust's POEM.¹⁸⁵⁷

In the United Kingdom, the residence of the trustees as a body is regulated by legislation.¹⁸⁵⁸ In Canada, recent case law established firmly that the central management and control test should be applied to trusts.¹⁸⁵⁹ The Canadian Income Tax Act deems a trust to be a Canadian resident under certain circumstances and a recent amendment to legislation now ensures that such a trust is also resident in Canada for DTT purposes.¹⁸⁶⁰ It is furthermore submitted that it is highly unlikely that a trust will be regarded as resident in the Netherlands in terms of the Dutch domestic law.¹⁸⁶¹

Article 4(3) of the OECD MTC uses POEM as the tiebreaker to determine the residence, for DTT purposes, of a person other than an individual. It is submitted that South Africa should apply the POEM test as the tiebreaker to resolve the residence of trusts for DTT purposes, thereby following the precedent set by international case law and the majority academic opinion. However, in order to address the possible uncertainty created by the Commentary to article 4(3), it is suggested that South Africa should insert a reservation to the Commentary, indicating that it will apply the POEM tiebreaker in relation to trusts.¹⁸⁶²

Concerning the meaning of the term POEM in article 4(3) of the OECD MTC, the Commentary indicates that it is the place where key management and commercial decisions necessary for the conduct of the entity's business as a whole are in substance made. It is submitted that by the amendment of the Commentary in 2008, the OECD suggested that a lower level of management (such as senior executives) as opposed to the highest level of management (such as a board of directors) can be responsible for the key management and commercial decisions of a business.¹⁸⁶³ The case law reveals that an entity is effectively managed by the highest level of management, that is, the place where the "shots are called", or where the top level of management is exercised. Usually, this level of management will be exercised by the board of directors in the case of a company, or by the trustee in the case of a trust.¹⁸⁶⁴

However, case law reveals that the effective management of a trust is often not exercised by the trustee of a trust. Yet, in all of the jurisdictions under discussion, in terms of trust law, only the trustees may manage a trust. A similar problem is encountered in situations involving companies, where a company can only act through certain organs, typically the board of directors. In *Unit Construction Co Ltd v Bullock (Inspector of Taxes)*¹⁸⁶⁵ the court held that it was irrelevant that the acts, which prove where central management and control is exercised, are irregular, unauthorised or unlawful. The residence of a company is determined by facts, not by the terms of its constitution. It is submitted that the same reasoning should be applied to trusts. Thus, even if trust instruments and trust law state that

¹⁸⁵⁷ See ch 6.3.1.3.4.

¹⁸⁵⁸ See ch 6.3.2.1.

¹⁸⁵⁹ See ch 6.3.3.1.

¹⁸⁶⁰ See ch 6.3.3.2.

¹⁸⁶¹ See ch 6.3.4.

¹⁸⁶² See ch 6.4.1.

¹⁸⁶³ See ch 6.4.3.1.

¹⁸⁶⁴ See ch 6.4.3.2.

¹⁸⁶⁵ *Unit Construction Co Ltd v Bullock (Inspector of Taxes)* [1960] AC 351 (HL).

only the trustee may manage (or administer) a trust, other persons (such as beneficiaries or advisors) may be held to be effectively managing the trust.¹⁸⁶⁶

It is submitted that the test laid down in *Wood v Holden (Inspector of Taxes)*,¹⁸⁶⁷ which outlines the circumstances under which it will be held that a board of directors are not effectively managing a company, can and should be applied by analogy to trustees managing a trust. Adapting the test for trusts, it is submitted that a distinction should be made between (a) cases where effective management of the trust is exercised by its trustees, and (b) cases where the functions of the trustees are usurped, in the sense that management is exercised independently of, or without regard to, the trustees. In cases which fall within item (a), it is essential to recognise the distinction (in concept, at least) between (i) the role of an “outsider” in proposing, advising and influencing the decisions which the trustees take in fulfilling their functions, and (ii) the role of an outsider who dictates the decisions which are to be taken. In that context an “outsider” is a person who is not himself or herself a participant in the formal process (for example, a meeting of trustees) through which the trustees fulfil their function.¹⁸⁶⁸ Further guidance from *Wood’s* case should also be borne in mind. If only a few transactions are undertaken by the trustees, the conclusion of those transactions will constitute the management of the trust by the trustees. Even if decisions are taken by the trustees without full and detailed information available to them, these are still valid trustee decisions and the functions of the trustees have not been usurped.¹⁸⁶⁹

The decision in *Commissioners for Her Majesty’s Revenue and Customs v Smallwood*¹⁸⁷⁰ cannot be supported and it is submitted that the court’s explanation of the reason why the test laid down in *Wood* is inappropriate, is unconvincing. Moreover, it is submitted that the *Smallwood* case was decided incorrectly on the facts in that the advisors and the settlor did not dictate to the trustees what their decisions should have been, but rather that the advisors and the settlor merely influenced the trustees’ decisions.¹⁸⁷¹

9.7 Attribution of income to a trust

A further requirement for the application of a DTT (patterned on the OECD MTC) to a trust (or trustee) is that income must be attributed to the trust (trustee). The OECD MTC uses several terms in its distributive rules to denote the connection between an item of income and a person. Yet the OECD MTC itself does not contain any attribution principles, leading academics to the conclusion that the attribution of income can be regarded as a matter for domestic law. However, the application of domestic attribution rules may lead to conflicts of attribution between two state parties to a DTT.¹⁸⁷² It is submitted that the solution suggested in the OECD’s report entitled *The Application of The OECD Model Tax Convention to Partnerships* (the Partnership Report),¹⁸⁷³ which is aimed at solving conflicts of classification, may be applied in respect of conflicts of attribution with regard to trusts. The

¹⁸⁶⁶ See ch 6.4.4.

¹⁸⁶⁷ *Wood v Holden (Inspector of Taxes)* [2006] EWCA Civ 26.

¹⁸⁶⁸ See ch 6.4.4.

¹⁸⁶⁹ See ch 6.4.3.2.

¹⁸⁷⁰ *Commissioners for Her Majesty’s Revenue and Customs v Smallwood* [2010] EWCA Civ 778.

¹⁸⁷¹ See ch 6.4.4.

¹⁸⁷² See ch 7.1.

¹⁸⁷³ OECD *The Application of The OECD Model Tax Convention to Partnerships*.

solution suggested in the Partnership Report is that the state of source should take into account, as part of the factual context, the way in which the item of income is treated in the residence state of the person claiming the benefits of the DTT and that the state of source should follow this treatment.¹⁸⁷⁴ A number of examples of conflicts of attribution involving trusts between the states studied in this dissertation were given.¹⁸⁷⁵ Many of these conflicts could be resolved, using the solution of the Partnership Report.¹⁸⁷⁶

9.8 Beneficial ownership and the trust

The last requirement for the application of a DTT (patterned on the OECD MTC) to trusts that was considered in this dissertation is beneficial ownership, a term used in certain articles of the OECD MTC. The meaning of the term is controversial. For example, it is not clear whether a domestic law meaning or an international fiscal meaning should be attached to this term when interpreting a DTT, although the latter seems to be the more accepted view.¹⁸⁷⁷ Furthermore, it is not clear whether a purely legal test or a more economic (or substance over form) test should be applied when establishing beneficial ownership.¹⁸⁷⁸ Academic authors have also offered many divergent views regarding the meaning of the term.¹⁸⁷⁹ The OECD Commentary on the meaning of the term beneficial owner has expanded over the period since its introduction in 1977 and, it is submitted, the meaning that the OECD attaches to the term has expanded with it. In the latest round, the OECD has issued a discussion draft and later a revised proposal containing proposed changes to the Commentary, in an attempt to clarify the meaning of the term. The eminent international cases on beneficial ownership have referred to the OECD Commentary, indicating the importance of the Commentary in determining the meaning of the term. It is submitted that the Commentary offers an international fiscal meaning of the term, a point underlined by the proposed changes.¹⁸⁸⁰

Court cases from around the world may provide some guidance regarding the meaning of the term beneficial owner. These cases reveal that the absence of an agent, trustee or nominee relationship is not conclusive to determine beneficial ownership. Prominence is given to the attributes of ownership (possession, use and enjoyment, risk and control) and the person who holds all these attributes will be considered the beneficial owner of the income. If an entity has absolutely no discretion as to the use or application of funds put through it as conduit, or if it has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it to do, it will not be regarded as the beneficial owner. However, the courts differ in the way in which they apply these tests. Some courts consider only legally binding rights and obligations, while others adopt a practical (or economic or substance over form) approach, or a combination of the two.¹⁸⁸¹

¹⁸⁷⁴ See ch 7.4.2.

¹⁸⁷⁵ See ch 7.3.

¹⁸⁷⁶ See ch 7.5.

¹⁸⁷⁷ See ch 8.2.1.

¹⁸⁷⁸ See chs 8.3–8.5.

¹⁸⁷⁹ See ch 8.5.

¹⁸⁸⁰ See ch 8.3.

¹⁸⁸¹ See ch 8.4.

The main purpose of the discussion on beneficial ownership was to ascertain whether a trust (or trustee) may be regarded as a beneficial owner for purposes of a DTT based on the OECD MTC. Case law seems to suggest that it cannot,¹⁸⁸² but some academic authors indicate that, at least under certain circumstances, a trust (or trustee) may be regarded as the beneficial owner (although other academics disagree).¹⁸⁸³ The OECD's revised proposal for the amendment of the Commentary is the strongest indication yet from the OECD that a trust (or trustee) could be a beneficial owner. It even provides an example in which a discretionary trust that accumulates the relevant income is held to be the beneficial owner. Since the discretionary trust that accumulates income is only an example of a trust that may be a beneficial owner, the other provisions of the Commentary were also analysed to determine when a trust will be regarded as a beneficial owner. Although it is accepted that in none of the states discussed in this dissertation will a trust (or trustee) be regarded as an agent or nominee of the beneficiaries or the settlor, the absence of an agency or nominee relationship is not conclusive to determine beneficial ownership. Under the proposed Commentary, it is submitted that a trust (or trustee) will not be a beneficial owner if its right to use and enjoy the income received is constrained by a contractual or legal obligation to pass on the payment to a beneficiary. Thus it was deduced that in the case of a vesting trust and in some cases where the trustees exercise their discretion in favour of a beneficiary during the year in which the income was received, the trust (or trustee) will not be regarded as the beneficial owner in terms of the Commentary. It is submitted that in terms of the proposed Commentary, if a discretionary trust accumulates the income, the trust (or trustee) will be regarded as the beneficial owner of the income even if, after a number of years, the trustee decides to vest the income in a beneficiary.¹⁸⁸⁴

Whether the courts will apply the meaning offered by the OECD MTC, depends on the view that a court takes of the role and status of the Commentary. In South Africa the role and status of the Commentary are still unclear, but the court is constitutionally required to consider foreign precedent. It is therefore difficult to predict which of the two views a court will follow, but it is submitted that in order to determine whether a trust can be the beneficial owner, a South African court should investigate where the attributes of ownership (identified in the Canadian cases as possession, use, risk and control) lie in each case. It is further submitted that, from a South African perspective, in the case of a discretionary trust, the attributes of possession, risk and control lie with the trust, but the attribute of use lies with the beneficiary. In the case of a vesting trust, only the attribute of possession lies with the trust, while the attributes of use, risk and control lie with the beneficiaries.¹⁸⁸⁵

The test for beneficial ownership formulated in the Canadian case of *Her Majesty the Queen v Prévost Car Inc*¹⁸⁸⁶ case (and confirmed in *Velcro Canada Inc v Her Majesty the Queen*¹⁸⁸⁷ case) refers to the person who holds *all* the attributes of ownership. Thus, in terms of the *Prévost* test and applying South African law, a trust would never be regarded as the beneficial owner of income. However, Du Toit regards the beneficial owner as the person whose ownership attributes outweigh those of all others. Danon views the power to control

¹⁸⁸² See ch 8.6.2.

¹⁸⁸³ See ch 8.6.1.

¹⁸⁸⁴ See ch 8.6.3.

¹⁸⁸⁵ See ch 8.6.4.

¹⁸⁸⁶ *Her Majesty the Queen v Prévost Car Inc* 2009 FCA 57.

¹⁸⁸⁷ *Velcro Canada Inc v Her Majesty the Queen* 2012 TCC 57.

the attribution of income as the most important ownership attribute. Using the views of these academic authors, it is therefore submitted that a discretionary trust may be the beneficial owner of income, since it holds three out of the four attributes of ownership (including control). In the case of a vesting trust, only one attribute (not control) lies with the trust and it is therefore submitted that it cannot be a beneficial owner. If this reasoning is applied, the same conclusion as that set out in the proposed Commentary is reached in respect of most types of trusts.¹⁸⁸⁸

9.9 The trust and the OECD MTC from a South African perspective

For the sake of convenience, the view that a court should take when applying a DTT modelled on the OECD MTC to South African trusts (according to this dissertation), is summarised in this paragraph. It is submitted that a court, when applying a DTT patterned on the OECD MTC to a South African trust:

- (a) Will regard the trust itself as the relevant taxpayer.
- (b) Will regard the trust as a person.
- (c) Will regard the trust itself as liable to tax in South Africa if it is a discretionary trust that accumulates all its income during the relevant year. It will not be regarded as liable to tax (and therefore not a resident for purposes of the DTT) if it is a vesting trust and all the income received by the trust is therefore vested in the hands of the beneficiary. If a discretionary trust accumulates part of its income and distributes the rest (or if it distributes all of its income during the relevant year), the trust is liable to tax in relation to the income that it accumulates, but, in relation to that portion of the income that is distributed to the beneficiaries, the beneficiaries resident in the relevant countries are entitled to the benefits of the applicable conventions, to the extent that they are liable to tax on the income distributed to them.
- (d) Should follow the case of *Crown Forest Industries*¹⁸⁸⁹ in interpreting the words “by reason of” in article 4(1) of the OECD MTC.
- (e) Will apply the POEM test set out in article 4(3) of the OECD MTC in determining the residence of a trust for treaty purposes. In this regard it is submitted that a trust is usually effectively managed by its trustee and it is the place where the trustee takes his or her decisions that will be relevant in determining the trust’s POEM. If the facts suggest that a trust is not effectively managed by its trustee, it is submitted that the test laid down in *Wood v Holden (Inspector of Taxes)*¹⁸⁹⁰ should be adapted and applied to determine whether the trustee effectively managed the trust.
- (f) May apply the solution suggested in the Partnership Report to conflicts of attribution involving trusts.
- (g) Should consider whether the trust holds the greatest weight of ownership attributes in order to determine whether a trust is the beneficial owner of income.

¹⁸⁸⁸ See ch 8.6.4.

¹⁸⁸⁹ *Crown Forest Industries Ltd v The Queen* [1995] 2 SCR 802.

¹⁸⁹⁰ *Velcro Canada Inc v Her Majesty the Queen* 2012 TCC 57.

9.10 Examples

Some practical examples, which were described in chapter 1, will illustrate how South Africa will apply a treaty based on the OECD MTC to a trust (in accordance with the principles set out in this dissertation).¹⁸⁹¹ For the sake of convenience, the facts are repeated here. In all of these examples, assume that the relevant DTT follows the wording of the OECD MTC and not the wording of the actual treaty between the two states.

- 9.10.1 Assume that an *inter vivos* trust instrument is signed in South Africa between the settlor and the trustees. Assume further that the settlor and trustees agree that South African law will apply to their agreement. The trustees are all Canadian residents. They fulfil their duties as trustees in Canada and all trustee meetings take place in Canada. The trust receives income from a South African source.

In both South Africa and Canada, the trust itself is a taxpayer and the trust itself will be regarded as a person for purposes of the OECD MTC.

South Africa will have to determine whether the trust is resident in South Africa. Since the trust was established or formed in South Africa (because the trust instrument was signed in South Africa), it will be regarded as a South African resident in terms of the Income Tax Act. In terms of Canadian domestic law, the trust will be regarded as having its central management and control in Canada (since the trustees fulfil all their duties there and all trustee meetings take place in Canada). Since both states regard the trust as resident, the tiebreaker in article 4(3) of the DTT will be applied. Hence, the POEM of the trust will have to be determined. It seems obvious that the POEM of the trust is in Canada and it will therefore be regarded as resident in Canada for DTT purposes. Accordingly, the trust will not be regarded as resident in South Africa for domestic law purposes.

- (a) Assume that the same trust is either a vesting trust or a discretionary trust that distributes all of its income to its beneficiaries during the relevant year.

Applying Canadian tax law, it is submitted that the trust is liable to tax in Canada and therefore resident in Canada for purposes of the DTT. Canada will probably also attribute the income to the trust. South Africa will attribute the income to the beneficiaries in terms of its domestic law.

- (b) If the beneficiaries are resident in Canada, it is submitted that the solution in the Partnership Report will oblige South Africa to take into consideration, as part of the factual context, that Canada attributes the income to the trust. It may therefore be argued that South Africa will have to regard the income as “paid to” or “derived by” the trust and hence no conflict of attribution will arise.

If applicable, South Africa will have to determine whether the trust is the beneficial owner of the income. In the case of a vesting trust it is unlikely that the trust’s ownership attributes will outweigh that of any other person and it

¹⁸⁹¹ See ch 1.3.

is therefore doubtful whether the trust will be the beneficial owner of the income. In the case of a discretionary trust, however, the ownership attributes of the trust will probably outweigh those of any other person and, consequently, it is submitted that the discretionary trust will be regarded as the beneficial owner of the income.

In the case of a discretionary trust that distributes its income during the relevant year, it is argued that South Africa will therefore reduce its tax claim in accordance with the treaty.

- (c) If the beneficiaries are resident in South Africa, the majority view in the Partnership Report will allow South Africa to tax the beneficiaries on the income received from the trust without reducing its tax claim in terms of the DTT.
- (d) If one assumes that the trust is a discretionary trust that accumulates its income, it will be regarded as liable to tax and therefore resident in Canada. Both Canada and South Africa will attribute the income to the trust and no conflict of attribution will arise. If beneficial ownership is a requirement, it is submitted that South Africa will view the trust as the beneficial owner, based on the fact that the trust's ownership attributes outweigh those of any other person.
- (e) If the facts remain the same as in (d), but it is further assumed that the settlor is resident in the Netherlands, the Netherlands will probably tax the settlor on the income earned by the Canadian trust. The solution in the Partnership Report will oblige South Africa to take into account the fact that the Netherlands attributes the income to the settlor and therefore regard the income as paid to or derived by the settlor for purposes of the DTT between South Africa and the Netherlands. It is submitted that the effect is thus that both the DTT between South Africa and Canada and the DTT between South Africa and the Netherlands would apply. South Africa's taxing rights would thus be restricted in terms of both treaties. The lowest amount of tax allowed under the two treaties should be used to satisfy South Africa's obligation.¹⁸⁹²

9.10.2 Assume that a trust is resident in South Africa in terms of South African domestic law and in terms of the relevant DTT. The trust receives income from Canada.

It is submitted that both South Africa and Canada will view the trust as a person. Both states will also regard the trust itself as a taxpayer.

- (a) Assume that the trust is either a vesting trust or a discretionary trust that distributes all of its income to its beneficiary during the relevant year. The beneficiary is resident in South Africa.

¹⁸⁹² The question whether the settlor will be regarded as the beneficial owner falls outside the scope of this dissertation.

Canada will most likely not regard the trust as resident in South Africa, since it is not liable to tax in terms of South African domestic tax legislation. However, applying the solution set out in the Partnership Report, Canada may take into account the fact that South Africa attributes the income to the beneficiary. The beneficiary is a resident of South Africa and liable to tax in South Africa. If the beneficial ownership requirement is applicable, It is submitted that Canada will be bound to the test laid down by its courts, so that the person who claims to be the beneficial owner will have to hold all the attributes of ownership. Whether Canada will view the beneficiary of a trust to be the beneficial owner of the income received by the trust in this instance was not examined in this dissertation (only the South African position was discussed), but it is likely, based on the decision in *Prévost*, that Canada will regard the beneficiary as the beneficial owner of the income. If this is the case, Canada will, arguably, be obliged to reduce its tax claim in accordance with the DTT. South Africa, as the residence state, will have to grant relief from double taxation to the beneficiaries.

- (b) Assume that the trust is a discretionary trust that accumulates all its income during the relevant year. The beneficiary is resident in South Africa.

South Africa will tax the income in the trust's hands and the trust will therefore be regarded as liable to tax for purposes of article 4(1) of the OECD MTC. Canada will probably attribute the income to the trust, as will South Africa. Therefore no conflict of attribution will arise. Canada will have to decide whether the trust will be regarded as the beneficial owner of the income. If it is regarded as such, it is submitted that Canada will have to reduce its tax claim in accordance with the DTT and South Africa will grant relief from double taxation. If Canada does not regard the trust as the beneficial owner, South Africa will only provide partial relief from double taxation.

- 9.10.3 Assume that the trustee of a vesting trust (and the trust itself) is resident in the United Kingdom. The trust receives income from a South African source, which the trustee mandates to the beneficiary.

- (a) If it is assumed that the beneficiary is resident in the United Kingdom, he or she will be liable to tax in the United Kingdom by reason of his or her residence and therefore also resident in the United Kingdom for treaty purposes. It is submitted that the United Kingdom attributes the income to the beneficiary in terms of its domestic law. South Africa will also attribute the income to the beneficiary by virtue of its domestic law and therefore no conflict of attribution will arise. South Africa will regard the beneficiary as the beneficial owner of the income, since the beneficiary's ownership attributes outweigh those of the trust (or trustee).
- (b) If it is assumed that the beneficiary is resident in Canada, he or she will also be regarded as a resident in Canada for treaty purposes. South Africa will attribute the income to the beneficiary, who is resident in Canada. However,

in terms of the Partnership Report, South Africa may take into consideration that Canada (it is submitted) attributes the income to the trust, which is resident in the United Kingdom. South Africa is therefore not obliged to grant the benefits of the DTT between South Africa and Canada in respect of the income.¹⁸⁹³

9.11 Closing remarks

Trusts are very versatile and flexible institutions and they can be used for a multitude of purposes. Their activities and transactions often span different jurisdictions, bringing with it the risk of international double taxation. Many of the states where trusts are known and used, enter into DTTs to mitigate the effect of double taxation. However, the application of DTTs to trusts is relatively unexplored territory. Especially in South Africa, many of the issues in relation to the application of DTTs to trusts, that have been addressed in other states, have not been contended with adequately. It is hoped that the legislature, treaty negotiators and the judiciary will take note of these uncertainties and address them in an appropriate manner. It is therefore hoped that this dissertation has made their task easier, by making a start in charting some of the features of a small part of the unexplored territory.

Certainly, there are many issues that still need to be addressed in future research. It is hoped that the OECD will fulfil its promise to draft a report on the application of the OECD MTC to trusts.¹⁸⁹⁴ Such a report will no doubt enhance the harmonisation and clarification which the OECD MTC seeks to achieve.

¹⁸⁹³ OECD *The Application of The OECD Model Tax Convention to Partnerships* para 51.

¹⁸⁹⁴ OECD *The Application of The OECD Model Tax Convention to Partnerships* para 1.

BIBLIOGRAPHY

Books

Anonymous *Canadian Master Tax Guide* 65 ed (2010) CCH Canadian Limited

Baker, P *Double Taxation Conventions: a Manual on the OECD Model Tax Convention on Income and on Capital* 3 ed (2002) Sweet & Maxwell

Bresser, HJ *Belastingplicht voor de Vennootschapsbelasting van Stichtingen en Verenigingen* 2 ed (2012) Sdu Uitgevers

Busby, N, Clark, B, Mays, R, Paisley, R and Spink, P *Scots Law: A Student Guide* 2 ed (2003) LexisNexis UK

Cameron, E, De Waal, M, Wunsh, B, Solomon, P and Kahn, E *Honoré's South African Law of Trusts* 5 ed (2002) Juta

Cassim, F, Cassim, M, Cassim, R, Jooste, R, Shev, J and Yeates, J *Contemporary Company Law* 2 ed (2012) Juta

Chamberlain, E and Whitehouse, C *Trust Taxation* 3 ed (2011) Sweet & Maxwell

Christie, R *The Law of Contract in South Africa* 5 ed (2006) LexisNexis Butterworths

Clegg, D and Stretch, R *Income Tax in South Africa* (2013) LexisNexis

Couzin, R *Corporate Residence and International Taxation* (2002) IBFD

Croome, B and Olivier, L *Tax Administration* (2010) Juta

Danon, RJ *Switzerland's Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* (2004) Linde Verlag

Davis, D, Olivier, L, Urquhart, G, Engels-Van Zyl, R and Roeleveld, J *Juta's Commentary on Income Tax* (2013) Juta

Davis, DM, Beneke, C and Jooste, R *Estate Planning* (2013) LexisNexis

De Broe, L *International Tax Planning and Prevention of Abuse: A Study under Domestic Tax Law, Tax Treaties and EC Law In Relation to Conduit and Base Companies* (2007) IBFD

De Koker, A and Williams, R *Silke on South African Income Tax* (2013) LexisNexis

Du Toit, CP *Beneficial Ownership of Royalties in Bilateral Tax Treaties* (1999) IBFD

Du Toit, F *South African Trust Law: Principles and Practice* 2 ed (2007) LexisNexis

Dugard, J *International Law: a South African Perspective* 4 ed (2011) Juta

- Edwardes-Ker, M *Tax Treaty Interpretation* (1994) Alfa Print
- Emslie, T, Davis, DM, Hutton, SJ and Olivier, L *Income Tax Cases and Materials* 3 ed (2001) The Taxpayer
- Ewens, DS *Canada Tax Service - McCarthy Tetrault Analysis* (2011)
- Garden, A and Mackintosh, S *Trusts and Estates in Scotland 2009/2010* (2009) Intl Specialized Book Service
- Gloag, W and Henderson, R *The Law of Scotland* 12 ed (2007) Thomson
- Gordon, KM, Manzano, XM and Tiley, J *Tiley and Collison's UK Tax Guide 2013-14* 31 ed (2013) LexisNexis
- Gretton, G, Steven, A and Struthers, A *Property, Trusts and Succession* (2009) Tottel Publishing
- Harris, P and Oliver, D *International Commercial Tax* (2010) Cambridge University Press
- Hayton, D *The Law of Trusts* 4 ed (2003) Sweet & Maxwell
- Heithuis, EJW, Kavelaars, P and Schuver, BF *Inkomstenbelasting alsmede Hoofdzaken Loonbelasting* (2013) Kluwer
- Hogg, PW, Magee, JE and Li, J *Principles of Canadian Income Tax Law* 7 ed (2010) Carswell
- Honiball, M and Olivier, L *The Taxation of Trusts in South Africa* (2009) Siberink
- Hudson, A *Equity and Trusts* 7 ed (2013) Routledge
- Hutton, M *Tolley's UK Taxation of Trusts* 20 ed (2010) LexisNexis
- Kessler, J *Taxation of Non-Residents and Foreign Domiciliaries* 11 ed (2012) Key Haven Publications PLC
- Kessler, J and Brown, H *Taxation of Charities and Non-Profit Organisations* 8 ed (2011) Key Haven Publications Ltd
- Kobetsky, M *International Taxation of Permanent Establishments: Principles and Policy* (2011) Cambridge University Press
- Larking, B *IBFD International Tax Glossary* 5 ed (2005) IBFD
- Moffat, G, Bean, G and Probert, R *Trusts Law* 5 ed (2009) Cambridge University Press
- Mowbray, J, Tucker, L, le Poidevin, N, Simpson, E and Brightwell, J *Lewin on Trusts* 18 ed (2008) Sweet & Maxwell
- OECD *Introduction to OECD Model Tax Convention on Income and on Capital* (2010)

- Olivier, L and Honiball, M *International Tax: a South African Perspective* 5 ed (2011) Siberink
- Olivier, P, Strydom, S and van den Berg, G *Trustreg en Praktyk* 2 ed (2011) LexisNexis Butterworths
- Oosterhoff, A, Chambers, R, McInnes, M and Smith, L *Oosterhoff on Trusts: Text, Commentary and Materials* 6 ed (2004) Thomson
- Panayi, C *Double Taxation, Tax treaties, Treaty-shopping and the European Community* (2007) Kluwer Law International
- Riddall, J *The Law of Trusts* 6 ed (2002) Butterworths
- Schwarz, J *Schwarz on Tax Treaties* (2009) CCH Wolters Kluwer (UK)
- Schwarz, J *Booth & Schwarz: Residence, Domicile and UK Taxation* 16 ed (2012) Bloomsbury Professional
- Stevens, SA *Belastingplicht in de Vennootschapsbelasting* (2009) Kluwer
- Te Spenke, G and De Vries, G *Taxation in the Netherlands* 4 ed (2011) Wolters Kluwer
- Thomas, G and Hudson, A *The Law of Trusts* (2004) Oxford University Press
- Van Der Merwe, DP *Information and Communications Technology Law* (2008) LexisNexis
- Van der Merwe, S, Van Huyssteen, L, Reinecke, M and Lubbe, G *Contract: General Principles* 3 ed (2006) Juta and Company Ltd
- Vogel, K, Engelschalk, M, Gorl, M, Hemmelrath, A, Lehner, M, Pollanth, R, Prokisch, R, Rodi, M, Stockmann, F and Tischbirek, W *Klaus Vogel on Double Taxation Conventions* 3 ed (1997) Kluwer Law International
- Ward, DA, De Broe, L, Killius, J, Le Gall, J, Miyatake, T, van Raad, K, Avery Jones, JF, Ellis, MJ, Goldberg, SH, Maisto, G, Torriane, H and Wiman, B *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries of the OECD Model* (2005) Kingston International Fiscal Association (Canadian Branch)
- Waters, D *Waters' Law of Trusts in Canada* 4 ed (2012)
- Wilson, W and Duncan, A *Trusts, Trustees and Executors* 2 ed (1995) W Green

Chapters in Books

- Anonymous "Algemene Inleiding " in C van Raad (eds) *Nederlandse Regelingen van Internationale Belastingrecht* (1964-) IA - 11 Kluwer - Deventer
- Anonymous "Het begrip 'persoon'" in C van Raad (eds) *Nederlandse Regelingen van Internationale Belastingrecht* (1964 -) IB - 275 Kluwer - Deventer

Arnold, B "Canada" in H Ault and B Arnold (eds) *Comparative Income Taxation: A Structural Analysis* (2004) 23 Kluwer Law International

Arnold, BJ "The Concept of Beneficial Ownership under Canadian Tax Treaties" in M Lang, P Pistone, J Schuch, C Staringer and A Storck (eds) *Beneficial Ownership: Recent Trends* (2013) 39 IBFD

Attard, T "Article 4 - Personal Scope: Companies and Non-Individuals" in T Ecker and G Ressler (eds) *History of Tax Treaties The relevance of the OECD Documents for the Interpretation of Tax Treaties* (2011) 197 Linde

Auerbach, X "Taxation of Trusts in the Netherlands" in RJ Danon, N Tissot and JL Chenaux (eds) *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* (2010) 223 Schulthess

Baker, P "An Approach to the Application of Double Taxation Conventions to Trusts" in M Cadesky and R Pease (eds) *Trusts and International Tax Treaties* (2006) 230 Tottel

Baker, P "United Kingdom: *Indofood International Finance Ltd v JP Morgan Chase Bank NA*" in M Lang, P Pistone, J Schuch, C Staringer and A Storck (eds) *Beneficial Ownership: Recent Trends* (2013) 27 IBFD

Bowman, S and Baker, A "Canada" in International Fiscal Association (eds) *Cahiers de Droit Fiscal International: Practical Issues in the Application of Double Tax Conventions* (1998) 285 Kluwer

Brincker, E "General Definitions" in A De Koker and E Brincker (eds) *Silke on International Tax* (2010) LexisNexis

Brincker, E "The Conclusion and Force of Double Taxation Agreements" in A de Koker and E Brincker (eds) *Silke on International Tax* (2010) LexisNexis

Brooks, K "Canada" in G Maisto (ed) *Residence of Companies under Tax Treaties and EC Law* (2009) 407 IBFD

Brown, C "Trusts - Canada" in T Lyons, V Chew and I Kireta (eds) *Topical Analysis* (2013) IBFD

Cadesky, M "Introduction and Overview of Issues" in M Cadesky and R Pease (eds) *Trusts and International Tax Treaties* (2006) 1 Tottel

Cantin Cumyn, M "The Québec Trust: A Civilian Institution with English Law Roots" in J Milo and M Smits (eds) *Trusts in Mixed Legal Systems* (2001) 73 Ars Aequi Libri

Cantin Cumyn, M "Reflections regarding the Diversity of Ways in which the Trust has been Received or Adapted in Civil Law Countries" in L Smith (eds) *Re-imagining the Trust* (2012) 6 Cambridge University Press

Carrothers, RB "Issues Concerning the OECD Model Treaty and Trusts" in M Cadesky and R Pease (eds) *Trusts and International Tax Treaties* (2006) 126 Tottel

De Boer, R "Netherlands" in G Maisto (ed) *Residence of Companies under Tax Treaties and EC Law* (2009) 551 IBFD

De Waal, M "Uniformity of Ownership, Numerus Clausus and the Reception of the Trust into South African Law" in J Milo and J Smits (eds) *Trusts in Mixed Legal Systems* (2001) 43 *Ars Aequi Libri*

De Waal, M "Comparative Succession Law" in M Reimann and R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) 1088 Oxford University Press

Du Plessis, LM "Statute Law and Interpretation" in WA Joubert (ed) *LAWSA* (2001) 211 Butterworths

Du Toit, C and Hattingh, PJ "Beneficial Ownership and Double Tax Conventions" in A De Koker and E Brincker (eds) *Silke on International Tax* (2010) Lexisnexis

Duff, DG "Beneficial Ownership: Recent Trends" in M Lang, P Pistone, J Schuch, C Staringer and A Storck (eds) *Beneficial Ownership: Recent Trends* (2013) 1 IBFD

Easson, A "Entity Entitlement to Treaty Benefits: A Conceptual Approach to Some Practical Problems" in B Arnold and J Sasseville (eds) *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* (2001) 12:1 International Fiscal Association (Canadian Branch)

Gretton, G "Scotland: The Evolution of the Trust in a Semi-Civilian System" in R Helmholz and R Zimmermann (eds) *Itinera Fiducia: Trust and Treuhand in Historical Perspective* (1998) 507 Duncker & Humblot

Hardy, A "Trusts - United Kingdom" in T Lyons, V Chew and I Kireta (eds) *Topical Analysis* (2013) IBFD

Hart, JW "How Various Countries Approach Taxation of Trusts" in M Cadesky and R Pease (eds) *Trusts and International Tax Treaties* (2006) 53 Tottel

Hattingh, PJ "South Africa" in G Maisto (ed) *Residence of Companies under Tax Treaties and EC Tax Law* (2009) 603 IBFD

Hattingh, PJ "Elimination of International Double Taxation" in A De Koker and E Brincker (eds) *Silke on International Tax* (2010) LexisNexis

Hayton, D "Trusts" in D Hayton, S Kortmann, A Nuytinck, A Struycken and N Faber (eds) *Vertrouwd met de Trust: Trust and Trust-like Arrangements* (1996) 3 WEJ Tjeenk Willink

Koele, IA "Trusts and the Application of the OECD Model Convention" in F Sonneveldt and H Van Mens (eds) *The Trust: Bridge or Abyss between Common and Civil Law Jurisdictions* (1992) 83 Kluwer Law and Taxation Publishers

Koppenol-Laforce, ME and Kottenhagen, RJP "The Institution of the Trust and Dutch Law" in E Hondius (eds) *Netherlands Reports to the Fifteenth International Congress of Comparative Law* (1998) 137 Intersentia Rechtswetenschappen

Kortmann, S and Verhagen, H "National Report for the Netherlands" in D Hayton, S Kortmann and H Verhagen (eds) *Principles of European Trust Law* (1999) 195 Kluwer Law International

Lyons, T "Trusts - Introduction" in T Lyons, V Chew and I Kireta (eds) *Topical Analysis* (2013) IBFD

Panayi, C "United Kingdom" in G Maisto (ed) *Residence of Companies under Tax Treaties and EC Law* (2009) 817 IBFD

Pijl, H "Netherlands" in International Fiscal Association (eds) *Cahiers de Droit Fiscal International: Conflicts in the Attribution of Income to a Person* (2007) 447 Sdu Fiscale & Financiele Uitgevers

Reid, K "National Report for Scotland" in D Hayton, S Kortmann and H Verhagen (eds) *Principles of European Trust Law* (1999) 67 Kluwer Law International

Reid, K "Partymony not Equity: the Trust in Scotland" in J Milo and J Smits (eds) *Trusts in Mixed Legal Systems* (2001) 19 Ars Aequi Libri

Reimer, E "How to Conceptualize Beneficial Ownership" in M Lang, P Pistone, J Schuch, C Staringer and A Storck (eds) *Beneficial Ownership: Recent Trends* (2013) 253 IBFD

Sassville, J "The Meaning of 'Place of Effective Management'" in G Maisto (ed) *Residence of Companies under Tax Treaties and EC Law* (2009) 287 IBFD

Schwarz, J "United Kingdom" in International Fiscal Association (eds) *Cahiers de Droit Fiscal International: Practical Issues in the Application of Double Tax Conventions* (1998) 703 Kluwer

Smit, DS "The Concept of Beneficial Ownership and Possible Alternative Remedies in Netherlands Case Law" in M Lang, P Pistone, J Schuch, C Staringer and A Storck (eds) *Beneficial Ownership: Recent Trends* (2013) 59 IBFD

Sonneveldt, F "The Trust - an Introduction" in F Sonneveldt and H van Mens (eds) *The Trust: Bridge or Abyss between Common and Civil Law Jurisdictions?* (1992) 14 Deventer : Kluwer Law and Taxation

Thuronyi, V and Easson, A "Fiscal Transparency" in V Thuronyi (eds) *Tax Law Design and Drafting* (1998) Ch 21 International Monetary Fund

Tremblay, R and Wharram, K "Partnerships, Trusts and Other Entities: Treaty Benefits" in B Arnold and J Sasseeville (eds) *Special Seminar on Canadian Tax Treaties: Policy and Practice: Text of Seminar Papers* (2001) 14:1 International Fiscal Association (Canadian Branch) Canadian Tax Foundation

Van Raad, C "Internationaal Belastingrecht" in H Mobach and L Sillevius (eds) *Cursus Belastingrecht* (2007) Vol 12 Deventer Gouda Quint

Verhagen, H "Het Haagse Trustverdrag" in D Hayton, S Kortmann, A Nuytinck, A Struycken and N Faber (eds) *Vertrouwd met de Trust: Trust and Trust-like Arrangements* (1996) 69 WEJ Tjeenk Willink

Wheeler, J "General Report" in International Fiscal Association (eds) *Cahiers de Droit Fiscal International: Conflicts in the Attribution of Income to a Person* (2007) 19 Sdu Fiscale & Financiële Uitgevers

Wheeler, J "Taxation of Trusts in Common Law Jurisdictions" in RJ Danon, JL Chenaux and N Tissot (eds) *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* (2010) 29 Schulthess

Widrig, M "The Expression 'by Reason of His Domicile, Residence, Place of Management ...' as Applied to Companies" in G Maisto (ed) *Residence of Companies under Tax Treaties and EC Law* (2009) 273 IBFD

Articles

Anonymous "The Taxation of Trust Income: s 25B of the Income Tax Act" (1992) 41 *The Taxpayer* 228

Anonymous "Double Taxation Agreement: South Africa and Australia Exchange of Information - Whether Australian Taxpayer "Taxpayer" for Purposes of Information-Gathering Power under the South African Income Tax Act read with the DTA" (2011) 60 *The Taxpayer* 232

Anonymous "You May be Right, Minister" (2012) 61 *The Taxpayer* 121

Arnold, BJ "The Interpretation of Tax Treaties: Myth and Reality" (2010) 64 *Bulletin for International Taxation* 1

Arnold, BJ "Tax Treaty News" (2011) 65 *Bulletin for International Taxation* 555

Arnold, BJ "Treaty Case Law News - A Trio of Recent Cases on Beneficial Ownership" (2012) 66 *Bulletin for International Taxation* 323

Avery Jones, J "The Treatment of Trusts under the OECD Model Convention: Part 1" (1989) 2 *British Tax Review* 41

Avery Jones, J "The Treatment of Trusts under the OECD Model Convention: Part 2" (1989) 3 *British Tax Review* 65

Avery Jones, J "Bodies of Persons" (1991) 11/12 *British Tax Review* 453

Avery Jones, J "The 'One True Meaning' of a Tax Treaty" (2001) 55 *Bulletin for International Taxation* 220

Avery Jones, J "Conflicts of Qualification: Comment on Prof Vogel's and Alexander Rust's Articles" (2003) 57 *Bulletin for International Taxation* 184

Avery Jones, J, Baker, P, De Broe, L, Ellis, M, Van Raad, K, Le Gall, J, Goldberg, S, Blessing, P, Ludicke, J, Maisto, G, Miyatake, T, Torrione, H, Vann, R, Ward, D, Nikolakakis, A and Wiman, B "The definitions of dividends and interest in the OECD Model: something lost in translation?" (2009) 4 *British Tax Review* 406

Avery Jones, J, Berg, CJ, Depret, H, Ellis, MJ, Fontaneau, P, Lenz, R, Miyatake, T, Roberts, SI, Sandels, C, Strobl, J and Ward, DA "The interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model - I" (1984) 1 *British Tax Review* 14

Avery Jones, J, Berg, CJ, Depret, H, Ellis, MJ, Fontaneau, P, Lenz, R, Miyatake, T, Roberts, SI, Sandels, C, Strobl, J and Ward, DC "The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model - II" (1984) 1 *British Tax Review* 90

Avery Jones, J and Nikolakakis, A "Commentary" (2012) 14 *International Tax Law Reports* 1090

Avery Jones, JF, De Broe, L, Ellis, MJ, van Raad, K, Le Gall, JP, Goldberg, SH, Killius, J, Maisto, G, Miyatake, T, Torrione, H, Vann, RJ, Ward, DA and Wiman, B "The Origins of Concepts and Expressions Used in the OECD Model and their Adoption by States" (2006) 60 *Bulletin for International Taxation* 220

Bernstein, J "Thoughts on the OECD Discussion Paper on Beneficial Ownership" (2011) 63 *Tax Notes International* 49

Berry, M "CRA Confirms Its Position on 'Liable to Tax'" (2007) 46 *Tax Notes International* 933

Boer, JP and Freudenthal, RM "'De identiteitscrisis van de Anglo-Amerikaanse trust': afgezonderd of niet?" (2009) June *Weekblad voor Privaatrecht, notariaat en registratie* 507

Bolgár, V "Why no Trusts in the Civil Law?" (1953) 2 *American Journal of Comparative Law* 208

Brender, MD "Symposium: Beneficial Ownership in Canadian Income Tax Law: Required Reform an Impact on Harmonization of Quebec Civil Law and Federal Legislation" (2003) 51 *Canadian Tax Journal* 311

Brown, C "Symposium: Beneficial Ownership and the Income Tax Act" (2003) 51 *Canadian Tax Journal* 402

Brown, CA "The Taxation of Trusts: Reconciling Fundamental Principles" (2001-2002) 21 *Estates, Trusts & Pensions Journal* 1

Classen, LG "The Exit Tax Consequences of the Migration of Companies from South Africa: Commissioner for the South African Revenue Service v Tradehold Ltd" (2013) 25 *SA Mercantile Law Journal* 387

Cleave, B "The treaty residence of trusts in the United Kingdom and Canada: some thoughts on the Smallwood and Garron (or St Michael Corp) cases" (2011) 6 *British Tax Review* 705

- Collier, R "Clarity, Opacity and Beneficial Ownership" (2011) 6 *British Tax Review* 684
- Danon, RJ "Conflicts of Attribution of Income Involving Trusts under the OECD Model Convention: the Possible Impact of the OECD Partnership Report" (2004) 32 *Intertax* 210
- Danon, RJ "Clarification of the Meaning of 'Beneficial Owner' in the OECD Model Tax Convention – Comment on the April 2011 Discussion Draft" (2011) 65 *Bulletin for International Taxation* 437
- Danon, RJ "Qualification of Taxable Entities and Treaty Protection" (2014) 68 *Bulletin for International Taxation* 1
- De Broe, L, Goyette, N, Martin, P, Rohatgi, R, Van Weeghel, S and West, P "Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions" (2011) 65 *Bulletin for International Taxation* 375
- De Graaf, A and Pötgens, F "Worrying Interpretation of 'Liable to Tax': OECD Clarification Would be Welcome" (2011) 39 *Intertax* 169
- De Waal, MJ "Anomalieë in die Suid-Afrikaanse Trustreg" (1993) 56 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 1
- De Waal, MJ "The Core Elements of the Trust: Aspects of the English, Scottish and South African Trusts Compared" (2000) 117 *South African Law Journal* 548
- De Waal, MJ "In Search of a Model for the Introduction of the Trust into a Civilian Context" (2001) 12 *Stellenbosch Law Review* 63
- Du Plessis, I "The Residence of A Trust for South African Income Tax Purposes" (2009) 21 *SA Mercantile Law Journal* 322
- Du Plessis, I "Some Thoughts on the Interpretation of Tax Treaties in South Africa" (2012) 24 *SA Mercantile Law Journal* 31
- Du Toit, C "The Evolution of the Term 'Beneficial Ownership' in Relation to International Taxation Over the Past 45 Years" (2010) 64 *Bulletin for International Taxation* 500
- Du Toit, F "Co-trusteeship and the joint-action rule in South African trust law" (2013) 27 *Trust Law International* 18
- Emslie, T "Capital Gains Tax - DTA between SA and Luxembourg - Whether Deemed CGT Disposal on Ceasing to be a Resident was an 'Alienation' for Purposes of DTA" (2012) 61 *The Taxpayer* 92
- Engelen, F "Some Observations on the Legal Status of the Commentaries on the OECD Model" (2006) 60 *Bulletin for International Taxation* 105
- Erasmus-Koen, M and Douma, S "Legal Status of the OECD Commentaries - in Search of the Holy Grail of International Tax Law" (2007) 61 *Bulletin for International Taxation* 339

Ferreira, G and Scholtz, W "Has the Constitutional Court found the lost ball in the high weeds? The interpretation of section 231 of the South African Constitution" (2009) *XL Comparative and International Law Journal of Southern Africa* 264

Galea, R "OECD - The Meaning of 'Liable to Tax' and the OECD Reports: Their Interaction and Ambiguous Interpretation" (2012) *66 Bulletin for International Taxation*

Goldberg, D "Some Thoughts on Corporate Residence" (2009) *VIII GITC Review* 1

Grundy, M "Case Note: Smallwood v Revenue Customs Commissioners" (2008) *VII GITC Review* 1

Gutuza, T "Has Recent United Kingdom Case Law Affected the Interplay Between 'Place of Effective Management' and 'Controlled Foreign Companies'?" (2012) *24 SA Mercantile Law Journal* 424

Hansen, HS, Christensen, LE and Pedersen, AE "Danish 'Beneficial Owner' Cases - a Status Report" (2013) *67 Bulletin for International Taxation* 192

Hattingh, PJ "South Africa: The Volkswagen Case and the Secondary Tax on Companies: Part 1 – The Outcome" (2009) *63 Bulletin for International Taxation* 442

Hattingh, PJ "The Tax Treatment of Partnerships under Model-based Bilateral Tax Treaties: Some Lessons from JJ Grundlingh v. The Commissioner for the South African Revenue Service" (2010) *127 South African Law Journal* 38

Hausman, JS "Interpreting Tax Treaties - A Canadian Perspective" (2001) *55 Bulletin for International Taxation* 93

Hayton, D "Developing the Use of Trusts in the Netherlands" (1997) *128 Weekblad voor Privaatrecht, Notariaat en Registratie* 542

Howard, C "Trust Funds in Common Law and Civil Law Systems: a Comparative Analysis" (2005) *2005 - 2006 University of Miami International and Comparative Law Review* 344

Jezzi, PL "The Concept of Beneficial Ownership in the Indofood and Prévost Car Decisions" (2010) *64 Bulletin for International Taxation* 253

Jooste, RD "Offshore Trusts and Foreign Income - the Specific Anti-avoidance Provisions" (2002) *Acta Juridica* 186

Kandev, M "Tax Treaty Interpretation: Determining Domestic Meaning Under Article 3(2) of the OECD Model" (2007) *55 Canadian Tax Journal* 31

Lang, M "Taxation of Income in the Hands of Different Taxpayers from the Viewpoint of Tax Treaty Law" (2001) *55 Bulletin for International Taxation* 596

Lawrence, D "Smallwood: Part 2 - Poetic Justice?" (2011) *2 Private Client Business* 77

Loomer, G "Smallwood Settlement v HMRC: Trust Residence for Treaty Purposes Located Wherever and Whenever the Trustees Take Decisions" (2009) 4 *British Tax Review* 378

Mössner, J "Klaus Vogel Lecture 2009 - Comments" (2010) 64 *Bulletin for International Taxation* 16

Oguttu, AW "Resolving Double Taxation: the Concept 'Place of Effective Management' Analysed from a South African Perspective" (2008) 41 *Comparative and International Law Journal* 80

Oguttu, A "Curbing 'treaty shopping': the 'beneficial ownership' provision analysed from a South African perspective" (2007) XL *Comparative and International Law Journal of Southern Africa* 237

Oliver, J "Beneficial Ownership and the OECD Model" (2001) 1 *British Tax Review* 27

Olivier, L "The Treatment of Trusts for Income and Capital Gains Tax Purposes: The Screws Tighten" (2002) *Tydskrif vir die Suid-Afrikaanse Reg* 220

Owen, P "Can Effective Management be Distinguished from Central Management and Control?" (2003) 4 *British Tax Review* 296

Prebble, J "Trusts and Tax Treaties" (2008) VIII *International Tax Planning Association Journal* 75

Roelofs, E "Niets is Zeker, ook de Fiscale Behandeling van de Fixed Trusts Niet" (2010) 6887 *Weekblad Fiscaal Recht* 1632

Roth, E "Canadian Taxation of Non-resident Trusts: A Critical Review of Section 94 of the Income Tax Act" (2004) 52 *Canadian Tax Journal* 329

Rowland, AK "Beneficial Ownership in a Corporate Context: What is it? When is it lost? Where does it go?" (1997) 3 *British Tax Review* 178

Sada Garibay, M "An Analysis of the Case Law on Article 3(2) of the OECD Model (2010)" (2011) 65 *Bulletin for International Taxation* 8

Salom, J "The Attribution of Income in Swiss and International Tax Law" (2011) 65 *Bulletin for International Taxation* 394

Scholtz, W "A Few Thoughts on Section 231 of the South African Constitution, Act 108 of 1996" (2004) 29 *South African Yearbook of International Law* 202

Schwarz, J "Tax Treaty Interpretation after Ben Nevis (Holdings) Ltd v. Her Majesty's Revenue and Customs (2013)" (2014) 68 *Bulletin for International Taxation* 20

Seiler, M "Exit Taxation Arising from a Deemed Disposal of Shares" (2013) 67 *Bulletin for International Taxation* 580

- Steindl, M and Stiasny, M "The Impact of the OECD Partnership Report (1999) on Tax Avoidance in Outbound Cases" (2014) 68 *Bulletin for International Taxation* 112
- Tuovinen, J "The Role of International law in Constitutional Adjudication: Glenister v President of the Republic of South Africa" (2013) 130 *South African Law Journal* 661
- Van Brunschot, F "The Judiciary and the OECD Model Tax Convention and its Commentaries" (2005) 59 *Bulletin for International Taxation* 5
- Van der Merwe, B "The meaning and relevance of the phrase vested right in income tax law" (2000) 12 *South African Mercantile Law Journal* 319
- Van der Merwe, B "Residence of a Company - the Meaning of 'Effective Management'" (2002) 14 *South African Mercantile Law Journal* 79
- Van der Merwe, B "The Phrase 'Place of Effective Management' Effectively Explained?" (2006) 18 *South African Mercantile Law Journal* 121
- Van Erp, S "A Dutch Perspective" (2011) 15 *Edinburgh Law Review* 479
- Van Weeghel, S and De Boer, R "Anti-abuse Measures and the Application of Tax Treaties in the Netherlands" (2006) 60 *Bulletin for International Taxation* 358
- Vogel "Tax Treaty News" (2001) 55 *Bulletin for International Taxation* 91
- Vogel "Conflicts of Qualification: the Discussion is not Finished" (2003) 57 *Bulletin for International Taxation* 41
- Ward, DA "The Role of the Commentaries on the OECD Model in the Tax Treaty Interpretation Process" (2006) 60 *Bulletin for International Taxation* 97
- Ward, DA, Avery Jones, J, De Broe, L, Van de Wiele, M, Ellis, MJ, van Raad, C, Lenz, R, Torriero, H, Mayatake, T, Roberts, SI, Goldberg, SH, Strobl, J and Maisto, G "A Resident of a Contracting State for Tax Treaty Purposes: A Case Comment on Crown Forest Industries" (1996) 44 *Canadian Tax Journal* 408
- Watson, G and Baum, S "Beneficial Ownership as a Treaty Anti-Avoidance Tool?" (2012) 60 *Canadian Tax Journal* 149
- Wheeler, J "The Attribution of Income to a Person for Tax Treaty Purposes" (2005) 59 *Bulletin for International Taxation* 477
- Wheeler, J "The Attribution of Income in the Netherlands and the United Kingdom" (2011) 3 *World Tax Journal* 39
- Wheeler, J "The Missing Keystone of Income Tax Treaties" (2011) 3 *World Tax Journal* 247
- Zigmond, J "Untelrab and Wensleydale: Reflections on Company and Trust Residence" (1996) 5 *Private Client Business* 316

Electronic articles

Dwyer, B (2011) *Country Analyses IBFD*
<http://online.ibfd.org.ez.sun.ac.za/document/cta_ca_s_1> (accessed on 20/03/2012)

Kosters, B (2011) *Country Analyses IBFD*
<http://online.ibfd.org.ez.sun.ac.za/document/cta_nl_s_1> (accessed on 20/03/2012)

Prebble, J (2004) 2 *eJournal of Tax Research*
<<http://www.austlii.edu.au/au/journals/eJITaxR/2004/10.html>> (accessed on 27/02/2013)

Swanepoel, N (2013) 10 *LitNet Akademies* <<http://www.litnet.co.za/Article/aantekening-die-plek-en-gesag-van-internasionale-reg-in-die-suid-afrikaanse-plaaslike-reg>> (accessed on 17/02/2014)

Tjaden, T (2005) *AALL Spectrum* <<http://www.nyulawglobal.org/globalex/Canada1.htm>> (accessed on 08/04/2011)

Vann, R (2012) 66 *Sydney Law School: Legal Studies Research Paper*
<<http://ssrn.com/abstract=2144038>> (accessed on 28/08/2013)

Dissertations

Boer, J *De Anglo-Amerikaanse trust in de inkomsten- en vennootschapsbelasting* Ph.D University of Leiden (2011)

Coetzee, JP *'n Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* Doctor Legum Universiteit van Suid-Afrika (2006)

Muller, C *Determining the Residence of a Trust: a South African Income Tax Perspective* LL.M University of Stellenbosch (2013)

Oguttu, AW *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* LL.D University of South Africa (2007)

West, C *The Taxation of International (non-resident) Sportspersons in South Africa* PhD University of Cape Town (2009)

Case law

South Africa

ABP 4x4 Motor Dealers (Pty) Ltd v IGI Insurance Co Ltd 1999 3 SA 924 (SCA)

Administrators Estate Richards v Nichol 1996 4 SA 253 (C)

AM Moolla Group Ltd v Commissioner for the South African Revenue Service 2003 65 SATC 414

Armstrong v Commissioner for Inland Revenue 1938 AD 343; 10 SATC 1

Boyd v Commissioner for Inland Revenue 1951 3 SA 525 (A)

Braun v Blann & Botha NNO 1984 2 SA 850 (A)

Canca v Mount Frere Municipality 1984 2 SA 830 (Tk)

Coetzee v Peet Smith Trust 2003 5 SA 674 (T)

Commissioner for Inland Revenue v Berold 1962 3 SA 748 (A)

Commissioner for Inland Revenue v Estate Greenacre 1936 NPD 225; 8 SATC 196

Commissioner for Inland Revenue v Friedman and Others NNO 1993 1 SA 353 (A)

Commissioner for Inland Revenue v MacNeillie's Estate 1961 3 SA 833 (A)

Commissioner for Inland Revenue v Simpson 1949 4 SA 678 (A)

Commissioner for Inland Revenue v Widan 1955 1 SA 226 (A)

Commissioner for Inland Revenue v Witwatersrand Association of Racing Clubs 1960 3 SA 291 (A)

Commissioner for the South African Revenue Service v Tradehold Ltd [2012] 3 All SA 15 (SCA)

Commissioner for the South African Revenue Service v Van Kets 2012 3 SA 399 (WCC)

Commissioner: South African Revenue Service v Woulidge 2002 1 SA 68 (SCA)

Crookes NO v Watson 1956 1 SA 277 (A)

Cupido v Kings Lodge Hotel 1999 4 SA 257 (E)

Deedat v The Master 1995 2 SA 337 (A)

Desai-Chilwan NO v Ross 2003 2 SA 644 (C)

Estate Dempers v Secretary for Inland Revenue 1977 3 SA 410 (A)

Estate Kemp v MacDonald's Trustee 1915 AD 491

Glenister v President of the Republic of South Africa 2011 3 SA 347 (CC)

Grundlingh v Commissioner for the South African Revenue Service 2009 72 SATC 1

Harksen v President of the Republic of South Africa 2000 2 SA 825 (CC)

Hoban v ABSA Bank Ltd t/a United Bank 1999 2 SA 1036 (SCA)

Hofer v Kevitt NO 1998 1 SA 382 (SCA)

Hoosen and Others NNO v Deedat 1999 4 SA 425 (SCA)

In re Jennett 1976 1 SA 580 (A)

Inland Revenue v Clark's Trustees 1939 SC 11

ITC 1473 1989 52 SATC 128 (C)

ITC 1503 1990 53 SATC 342 (T)

ITC 1544 1992 54 SATC 456 (T)

ITC 1735 2002 64 SATC 455

ITC 227 (1931) 6 SATC 234 (U)

Jafta v Ezemvelo KZN Wildlife 2008 10 BLLR 954 (LC)

Jamieson v Sabingo 2002 4 SA 49 (SCA)

Jewish Colonial Trust v Estate Nathan 1940 AD 163

Knoop NNO v Birkenstock Properties (Pty) Ltd Unreported judgement of the Free State High Court, 4 June 2009, Case No. : 7095/2008

Kohler v Commissioner for Inland Revenue 1949 4 SA 1022 (T)

Kommissaris van Binnelandse Inkomste v Lotz 1998 (2) SA 282 (O)

Kriel v Terblanche NO 2002 6 SA 132 (NC)

Lamb v Commissioner for Inland Revenue 1955 1 SA 270 (A)

Land and Agricultural Bank of South Africa v Parker 2005 2 SA 77 (SCA)

Lupacchini NO v Minister of Safety and Security 2010 6 SA 457 (SCA)

Magnum Financial Holdings (Pty) Ltd (In Liquidation) v Summerly and Another NNO 1984 1 SA 160 (W)

Mariola v Kaye-Eddie NO 1995 2 SA 728 (W)

Mzeku v Volkswagen SA (Pty) Ltd 2001 4 SA 1009 (LAC)

Ndlovu v Ngcobo; Bekker v Jika 2003 1 SA 113 (SCA)

Nel v Metequity Ltd 2007 3 SA 34 (SCA)

Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd 1976 1 SA 441 (A)

Ovenstone v Secretary for Inland Revenue 1980 2 SA 721 (A)

Pascoal v Wurdeman 2012 3 SA 422 (GSJ)

Rosner v Lydia Swanepoel Trust 1998 2 SA 123 (W)

S v H 2007 3 SA 330 (C)

Scania South Africa (Pty) Ltd v Smit 2003 1 SA 457 (T)

Secretary for Inland Revenue v Downing 1975 4 SA 518 (A)

Secretary for Inland Revenue v Rosen 1971 1 SA 172 (A)

Seton Co v Silveroak Industries Ltd 2000 2 SA 215 (T)

Simplex (Pty) Ltd v Van der Merwe & Others NNO 1996 1 SA 111 (W)

Standard Bank of South Africa Ltd v Ocean Commodities Inc 1983 1 SA 276 (A)

The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service 74 SATC 127

Thorpe v Trittenwein 2007 2 SA 172 (SCA)

Tick v Broude 1973 1 SA 462 (T)

Van der Merwe v Van der Merwe 2000 2 SA 519 (C)

Volkswagen of South Africa (Pty) Ltd v Commissioner for the South African Revenue Service 70 SATC 195

Walele v City of Cape Town 2008 6 SA 129 (CC)

Yarram Trading CC t/a Tijuana Spur v ABSA Bank Ltd 2007 2 SA 570 (SCA)

United Kingdom

Archer-Shee v Garland (1931) 15 TC 693

Ayerst (Inspector of Taxes) v C&K (Construction) Ltd [1975] STC 345 HL

Baker v Archer-Shee [1927] AC 844 HL

Ben Nevis (Holdings) Ltd v Her Majesty's Revenue and Customs [2013] EWCA Civ 578

Carleton v Thomson 1867 5 M (HL) 151

Commissioners for Her Majesty's Revenue and Customs v Smallwood [2010] EWCA Civ 778

De Beers Consolidated Mines Ltd v Howe [1906] AC 455 (HL)

English Sewing Cotton Company Ltd v IRC [1947] 1 All ER 679

Gartside v IRC [1968] 1 All ER 121

Indofood International Finance Ltd v JP Morgan Chase Bank NA [2006] EWCA Civ 158

IRC v Collco Dealings Ltd (1961) 39 TC 509 (HL)

IRC v Commerzbank AG [1990] STC 285

J Sainsbury plc v O'Connor (Inspector of Taxes) [1991] STC 318 CA

Laerstate BV v HMRC [2009] UKFIT 209 (TC)

Memec plc v IRC 1998 [1998] STC 754

Padmore v IRC (No 2) [2001] STC 280

Padmore v The Commissioners of Inland Revenue [1989] STC 493

Parway Estates Ltd v IRC (1958) 45 TC 135

R (on the application of Huitson) v HMRC [2010] EWHC 97 (Admin)

R v Secretary of State for the Home Department ex parte Adan [2001] 2 WLR 143

Reid's Trustee v IRC 14 TC 512

Royal Trust Co v Tucker [1982] 1 SCR 250

Saunders v Vautier (1841) 4 Beav 115

Smallwood v The Commissioners for Her Majesty's Revenue and Customs [2009] EWHC 777 (Ch)

Sun Life Assurance Co of Canada v Pearson [1986] STC 335 CA

Trevor Smallwood Trust v The Commissioners for Her Majesty's Revenue and Customs (2008) Sp C 669

Unit Construction Co Ltd v Bullock (Inspector of Taxes) [1960] AC 351 (HL)

Wensleydale's Settlement Trustees v IRC [1996] STC (SCD) 241

Williams v R 2005 TCC 558

Wood Preservation Ltd v Prior (Inspector of Taxes) (1968) 45 TC 112 CA

Wood v Holden (Inspector of Taxes) [2006] EWCA Civ 26

Woodend (KV & Ceylon) Rubber & Tea Co Ltd v CIR [1971] AC 321

Canada

Alberta Power (2000) Ltd v Her Majesty the Queen 2009 TCC 412

Crown Forest Industries Ltd v The Queen [1995] 2 SCR 802

Fundy Settlement v Canada 2012 SCC 14, [2012] 1 SCR 520

Garron v R 2009 TCC 450; 12 ITLR 79

Her Majesty the Queen v Prévost Car Inc 2009 FCA 57

Her Majesty the Queen v Peter Sommerer 2012 FCA 207

Larose (M) v MNR [1992] 2 CTC 2339

MNR v Saunders (1954) 54 DTC 524

Peter Sommerer v Her Majesty the Queen 2011 TCC 212

Prévost Car Inc v Her Majesty the Queen 2008 TCC 231

RMM Canadian Enterprises Inc v R (1997) 97 DTC 302

Robert MO Morris and Neville Leroy Smith Trustees of the RCI Trust v Minister of National Revenue 2009 FC 434

St Michael Trust Corp as Trustee of the Fundy Settlement v Her Majesty the Queen 2010 FCA 309

TD Securities (USA) LLC v Her Majesty the Queen 2010 TCC 186

The Minister of National Revenue v Robert MO Morris 2009 FCA 373

Velcro Canada Inc v Her Majesty the Queen 2012 TCC 57

Netherlands

Hoge Raad 6 April 1994 No 28 638 BNB 1994/217

2009 HR 08/05071

Others

Linklaters LLP v Income tax Officer - International Taxation Ward 1(1)(2), Mumbai ITA No 4896/Mum/03 and 5085/Mum/03

A.A/S v Federal Tax Administration A-6537/2010

Sharp v Thomson 1995 SLT 837

Tata Industries v Deputy Director of International Tax (Mumbai) 2011 No 38 of 2010

BFH decision of 20 August 2008 I R 39/07

DK LK 1 Nov 2010 SKM 2010 729

DK ØL 20 Dec 2011 SKM 2012 121

Legislation

South Africa

Companies Act 71 of 2008

Constitution of the Republic of South Africa 1996

Customs and Excise Act 91 of 1964

Electronic Communications and Transactions Act 25 of 2002

Electronic Communications and Transactions Amendment Bill (draft) in GN 888 of 2012 GG 35821 of 26-10-2012

Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003

Income Tax Act 58 of 1962

Interpretation Act 33 of 1957

Interpretation Act 5 of 1910

Recognition and Enforcement of Foreign Arbitral Awards Act 40 of 1977

Tax Administration Act 28 of 2011

Taxation Laws Amendment Act 22 of 2012

Trust Moneys Protection Act 34 of 1934

Trust Property Control Act 57 of 1988

Wills Act 7 of 1953

United Kingdom

Corporation Tax Act 2009

Income and Corporation Taxes Act 1988

Income Tax (Trading and Other Income) Act 2005

Income Tax Act 2007

Interpretation Act 1978

Law of Property Act 1925

Law Reform (Miscellaneous Provisions) (Scotland) Act 1968

Perpetuities and Accumulations Act 1964

Perpetuities and Accumulations Act 2009

Recognition of Trusts Act 1987

Requirements of Writing (Scotland) Act 1995

Scotland Act 2012

Statute of Frauds 1677

Taxation (International and Other Provisions) Act 2010

Trustee Act 1925

Trustee Act 2000

Trustee Delegation Act 1999

Trusts (Scotland) Act 1921

Trusts (Scotland) Act 1961

Wills Act 1837

Canada

Civil Code of Lower Canada

Civil Code of Québec SQ 1991 ch 64

Income Tax Act RSC 1985 (5th supp) ch 1

Income Tax Conventions Interpretation Act RSC 1985 c I-4

Ontario Trustee Act RSO 1990 ch T23

Statute of Frauds 1677

Taxation Act RSQ 1-3

Trustee Act CCSM ch T160

Trustee Act RSBC 1996 ch 464

Trustees Act RSNB 1973 ch T – 15

The Netherlands

Algemene wet inzake rijksbelasting 1959

Civil Code 1992

Grondwet voor het Koninkrijk der Nederlanden 2002

Wet Conflictenrecht Trust 1995

Wet inkomstenbelasting 2001

Wet op de dividendbelasting 1965

Wet op de vennootschapsbelasting 1969

International Conventions and Double Taxation Treaties

Convention Between Canada and the Kingdom of the Netherlands signed on 27 May 1986, as amended

Convention between the Government of Canada and the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed on 27 November 1995

Convention on the Law Applicable to Trusts and on their Recognition 1985

Protocol Amending the Convention Between the Government of Canada and the Government of the United Kingdom of Great Britain and Northern Ireland signed on May 7 2003

Vienna Convention on the Law of Treaties 1969

Reports

South Africa

Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa *5th Interim Report of the Commission of Inquiry into certain Aspects of the Tax Structure of South Africa - basing the South African Income Tax System on the Source or Residence Principle - Options and Recommendations* (1997)

National Treasury *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012* (2012)

South African Revenue Service *Discussion Paper on Interpretation Note 6: Place of Effective Management* (2011)

South African Revenue Service *Resident: Place of Effective Management (Persons other than Natural Persons)* Interpretation Note No 6 (2002)

United Kingdom

Her Majesty's Revenue and Customs *Clarifying the Scope of the Scottish Rate of Income Tax* (2012)

Her Majesty's Revenue and Customs *Extra-Statutory Concessions* B18

Her Majesty's Revenue and Customs *International Manual* (2013)

Her Majesty's Revenue and Customs *Manual on Trusts* (2013)

Her Majesty's Revenue and Customs *Trustee Residence Guidance* (2009)

Tax Faculty of the Institute of Chartered Accountants in England and Wales; The Chartered Institute of Taxation; Society of Trust and Estate Practitioners *Trustee Residence Taxguide* (2010)

Canada

Minister of Finance *Explanatory Notes Relating to the Income Tax Act, the Excise Tax Act and Related Legislation* (2012)

Ward, DA *Access to Tax Treaty Benefits: Research Report Prepared for the Advisory Panel on Canada's System of International Taxation* (2008)

The Netherlands

Ministerie van Financiën *Notitie Fiscaal Verdragsbeleid* (2011)

OECD

OECD *Clarification of the Meaning of "Beneficial Owner" in the OECD Model Tax Convention: Discussion Draft* (April 2012)

OECD *Discussion Draft on the Application of Tax Treaties to State-owned Entities, Including Sovereign Wealth Funds* (2010)

OECD *Double Tax Conventions and the Use of Conduit Companies* (1987)

OECD *OECD Model Tax Convention: Revised Proposal Concerning the Meaning of "Beneficial Owner" in Articles 10, 11 and 12* (October 2012)

OECD R(24). *The granting of treaty benefits with respect to the income of collective investment vehicles* (2012)

OECD *Tax Treaty Issues Related to REITS Public Discussion Draft* (2007)

OECD *The Application of The OECD Model Tax Convention to Partnerships* (1999)

OECD *Working Party No 14 of the Fiscal Committee Third Report on the Article on Definitions* (1962)

Organisation for European Economic Co-operation *Working Party no 14 of the Fiscal Committee Second Report on the Article on Definitions* (1961)

Websites

Anonymous "Trade Treaties International Conventions" 24.10.2002 *Juris International*
<<http://www.jurisint.org/en/ins/421.html>> (accessed on 31/05/2011)

The Davis Tax Committee "Introduction" *The Davis Tax Committee*
<<http://www.taxcom.org.za/index.html>> (accessed on 18/02/2014)

Croome, B "The Future Taxation of Trusts" *ENS Africa*
<http://www.ensafrica.com/Uploads/Images/news/2_August_2013_-_The_Legal_Times_-_The_future_taxation_of_trusts_.pdf> (accessed on 18/02/2014)

Falk, C and Morand, S "Budget 2013: A Response to Sommerer" *McCarthy Tetrault*
<http://www.mccarthy.ca/article_detail.aspx?id=6260> (accessed on 04/11/2013)

Minister of Finance, "Budget Review" *National Treasury*
<<http://www.treasury.gov.za/documents/national%20budget/2013/review/chapter%204.pdf>> (accessed on 18/02/2014)

Minister of Finance, "Budget Speech" *National Treasury*
<<http://www.treasury.gov.za/documents/national%20budget/2013/speech/speech.pdf>> (accessed on 18/02/2014)

OECD "History" *OECD*
<http://www.oecd.org/document/25/0,3746,en_36734052_36761863_36952473_1_1_1_1,00.html> (accessed on 27/05/2011)

OECD "Members and Partners" *OECD*
<http://www.oecd.org/pages/0,3417,en_36734052_36761800_1_1_1_1_1,00.html> (accessed on 27/05/2011)

OECD "Enhanced Engagement" *OECD*
<http://www.oecd.org/document/36/0,3746,en_2649_201185_41668772_1_1_1_1,00.html> (accessed on 27/05/2011)

OECD "Who does What?" *OECD*
<http://www.oecd.org/pages/0,3417,en_36734052_36761791_1_1_1_1_1,00.html> (accessed on 27/05/2011)

OECD "OECD approves the 2010 Update to the OECD Model Tax Convention" *OECD*
<http://www.oecd.org/document/32/0,3746,en_2649_33747_45689952_1_1_1_1,00.html> (accessed on 27/05/2011)

Tjaden, T "Researching Canadian Law" *Globalex*
<http://www.nyulawglobal.org/globalex/Canada1.htm#_The_Canadian_Legal_System> (accessed on 08/04/2011)